
Jean Monnet Chair Papers

At Home Abroad, Abroad at Home: International Liberalization and Domestic Stability in the New World Economy

JOHN GERARD RUGGIE



the Robert Schuman Centre at the
European University Institute

EUROPEAN UNIVERSITY INSTITUTE



3 0001 0021 8399 6

Jean Monnet Chair Papers

**RUGGIE: *At Home Abroad, Abroad at Home:
International Liberalization and Domestic Stability
in the New World Economy***

**WP 320
EUR**

Jean Monnet Chair Papers

20

The Jean Monnet Chair

The Jean Monnet Chair was created in 1988 by decision of the Academic Council of the European University Institute, with the financial support of the European Community. The aim of this initiative was to promote studies and discussion on the problems, internal and external, of European Union following the Single European Act, by associating renowned academics and personalities from the political and economic world to the teaching and research activities of the Institute in Florence.

Jean Monnet Chair Papers

At Home Abroad, Abroad at Home: International Liberalization and Domestic Stability in the New World Economy

JOHN GERARD RUGGIE

1995

The Robert Schuman Centre at the
European University Institute

**All rights reserved.
No part of this paper may be reproduced in any form
without permission of the author.**

**© John Gerard Ruggie
Printed in Italy in February 1995
European University Institute
Badia Fiesolana
I-50016 San Domenico (FI)
Italy**

**Dedicated to Ernst B. Haas
on the occasion of his seventieth birthday**

**He translated Jean Monnet's dream of a practical peace
into the social scientific study of international transformation
and instilled a commitment to both in his students
of whom I was privileged to be one.**

Table of Contents

Introduction	p. 9
I. Economic Stabilization	p. 11
Embedded Liberalism in Trade	p. 14
Discontinuities or Adaptive Change?	p. 16
The "New Protectionism"	p. 17
Managed Trade	p. 21
Coercive Discrimination	p. 23
Aggressive Unilateralism	p. 25
Conclusion	p. 29
II. Institutional Transformation	p. 32
Contested Domestic Domains	p. 32
Domestic Structures	p. 34
Greening Trade	p. 37
Labor Standards	p. 43
Globalization	p. 47
Markets	p. 48
Hierarchies	p. 49
Networks	p. 53
Intangibles	p. 54
Welfare Capitalism	p. 58
Conclusion	p. 61
Biographical Note	p. 63

Introduction

The two most enduring contemporaneous accounts of the interwar period are E. H. Carr's *The Twenty Years' Crisis* and Karl Polanyi's *The Great Transformation*.¹ The perspectives from which the two authors wrote could barely have differed more. Carr is best remembered today for pulverizing the idealist foundations of liberal internationalism and preparing the ground, thereby, for the postwar ascendancy of realist discourse in the academic study of international relations. Polanyi's intellectual pedigree and legacy are more complex. He delivered a searing indictment of the social destructiveness of unregulated market forces and the moral mutilation of market rationality. For these views, Polanyi was later adopted by the new left. But he anchored his critique in an organic conception of society that was, in fact, deeply conservative in the traditionalist sense of that term.

Despite their differences, Carr and Polanyi reached similar conclusions about the future of the world economy. Both believed they had witnessed, in Polanyi's words, "the passing of capitalist internationalism," or, as Carr depicted it, the "abnormal, *laissez-faire* interlude of the nineteenth century."² And both felt that the drive to reimpose social and political imperatives on the self-regulating market which had swept the industrialized countries in the 1930s would be extended into the international arena after the war. "Internationally," Carr felt, "the consequences of absolute *laissez-faire* are as fantastic and as unacceptable as are the consequences of *laissez-faire* within the state."³ Polanyi concurred. "Out of the ruins of the Old World, the cornerstones of the New can be seen to emerge: economic collaboration of governments *and* the liberty to organize national life at will."⁴

For nearly a half century, the economic collaboration of governments that Carr and Polanyi foresaw has been pursued within a form of multilateralism consistent with the maintenance of domestic stability – what I have elsewhere called the embedded liberalism compromise.⁵ Societies were asked to embrace the change and dislocation attending international liberalization. But liberal-

¹ Edward Hallett Carr, *The Twenty Years' Crisis, 1919-1939: An Introduction to the Study of International Relations* (1939; New York: Harper & Row, 1964), and Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (1944; Boston: Beacon Books, 1957).

² Polanyi, p. 248; Carr, p. 116.

³ Carr, p. 121.

⁴ Polanyi, pp. 253-254, italics in original.

⁵ John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization*, 36 (Spring 1982).

ization and its effects were constrained, in turn, by the newly acquired domestic policy roles of governments. Part I summarizes the nature of this compromise in the domain of international trade, and traces its evolution to the present. I argue that, with some exceptions, the compromise has held up remarkably well, notwithstanding criticism to the contrary that typically focuses on the practices of the so-called new protectionism.

In part due to the success of this postwar arrangement, capital has become globally more mobile as well as more transnationalized in organization and integrated in scope than Carr or Polanyi could ever have imagined. We are, therefore, entering an entirely new era in the evolution of the world economy. Part II develops a schematic and provisional formulation of this new world economy's key institutional features. I argue that one of their generic consequences is the growing "disembeddedness" of international economic forces from the institutional frameworks and policy instruments governments have been employing to buffer the pursuit of domestic economic and social objectives. Some observers may find this outcome "fantastic" in the positive sense of the word, because of its presumed global efficiency and welfare effects. But it could end up being "fantastic" as Carr meant it: fanciful, due to doubts about its domestic political viability.

In neither story do I find the widespread tendency to view the behavior of governments through the lenses of free trade vs. protectionism to be particularly helpful. In the first, the lenses distort and exaggerate the dangers of protectionism. In the second, they misconstrue the nature of the problem altogether. Throughout, therefore, the attempt is made to correct for these lenses and to provide a more grounded and less of a textbook view of the political economy of international trade. Finally, telling both stories from the vantage point of the United States draws attention to a potentially key difference between postwar efforts at institutional reconstruction and the current need to adapt and reconfigure what was then created: the ability and willingness of the U.S. to act in support of the international economic order.

In short, the world in 1995 finds itself faced with a challenge which in some respects is not unlike the one it faced in 1945: devising a form of international liberalization that is consistent with domestic economic and social stability. Deepening our understanding of the earlier effort may shed some guiding light on the complex and difficult tasks that lie ahead.

I. Economic Stabilization

Efforts to reconstruct the postwar international economic order began amid raging world war, coupled with painful memories of the Great Depression, beggar-thy-neighbor trade and monetary policies, and outright economic warfare. Understandably, the reconstruction reflected, above all, a quest for normalcy, a search for stability. "Historians often treat stability as a passive coming to rest or a societal inertia that requires no explanation," Charles Maier has written. "In fact, stabilization is as challenging a historical problem as revolution."⁶ The challenge was especially acute for the architects of the postwar economic order because they were obliged to reconcile two dimensions of stabilization that history had shown to stand in contradiction.

The United States sought to create an open and nondiscriminatory international economic order. But a mere return to the gold standard and free trade was rejected on the grounds that they would destabilize domestic employment and social welfare objectives. Harry Dexter White, who drafted the U.S. plan for the postwar monetary regime, dismissed them as "harmful hangovers from a nineteenth century creed."⁷ At the same time, the uncoordinated pursuit of domestic stabilization was rejected because it had triggered the mutually destructive spirals of the 1930s, thereby showing itself to be incompatible with international openness and nondiscrimination. This tension between the requirements of international and domestic stability was resolved by means of the heterodox institutional formula of "embedded liberalism." Unlike the economic nationalism of the thirties, the inter-national economic order would be multilateral in character. But unlike the *laissez-faire* liberalism of the gold standard and free trade, its multilateralism would be predicated upon the interventionist character of the modern capitalist state. Finally, the forms of domestic intervention were expected to be broadly compatible with economic openness and expansion.

Stability was achieved in due course and a period of unprecedented economic expansion ensued. The cold war, far from being an impediment to instituting the multilateral economic order, facilitated it. The socialist countries dropped out early on, making it easier to devise and implement multilateral

⁶ Charles S. Maier, "The Two Postwar Eras and the Conditions for Stability in Twentieth-Century Western Europe," *American Historical Review*, 86 (April 1981), p. 327. I should point out that both Maier and I use the term stabilization in the broad sense of restoring a sustainable institutional order in domestic and international economic relations – not the narrower technical sense of macroeconomic stabilization policies as used by the International Monetary Fund.

⁷ In the 1942 draft of the plan, as cited by G. John Ikenberry, "A World Economy Restored: Expert Consensus and the Anglo-American Settlement," *International Organization*, 46 (Winter 1992), p. 298.

monetary and trade regimes. And bipolarity made it easier for the Western capitalist countries to compromise and make sacrifices for the sake of their common front against the communist East.⁸ Even before the collapse of the communist system, several of its constituent states sought entry into the multi-lateral economic regimes. Since 1989, almost all the rest have done so, as have most of the developing countries, making these the first economic regimes in history to achieve virtual universality.

And yet, for over twenty years now serious observers have detected a "disastrous isolationist trend" in U.S. foreign economic policy, as the well-known economic policy analyst Fred Bergsten characterized it as early as 1972. Bergsten predicted deleterious consequences for the international economic order; warned of "the first real international trade war since the 1930s;" and reminded us that "trade wars could become full economic wars, precisely as they did under similar international conditions in the 1930s."⁹ A decade later, it was Robert Reich's turn to alert the world to the "collapse of free-trade ideology into retaliatory protectionism."¹⁰ Similar concerns abound today.¹¹

Clearly, something is amiss, either in the world of economic policy or in the perspectives that many observers have brought to bear on it. Successful expansion and imminent disaster do not as a rule simultaneously describe the same phenomenon. One key problem, in fact, is that analysts frequently have misunderstood or ignored actual institutional designs and frameworks, judging the behavior of governments instead by theoretical maxims or even ideological preferences. Peter Kenen confessed as much some time ago in the context of international monetary reforms: "Without always knowing, most of us have judged events, decisions, and proposals by an idealistic, cosmopolitan criterion. We have asked how far each step has taken us toward the creation of a

⁸ The "security externalities" of trade policy within bipolar systems are demonstrated deftly by Joanne Gowa, "Bipolarity, Multipolarity, and Free Trade," *American Political Science Review*, 83 (December 1989); and Joanne Gowa and Edward Mansfield, "Power Politics and International Trade," *American Political Science Review*, 87 (June 1993).

⁹ These citations are from C. Fred Bergsten, "The New Economics and U.S. Foreign Policy," *Foreign Affairs*, 50 (January 1972), assessing the implications the 1971 Nixon-Connally shifts in U.S. international economic policy (closing the gold window, imposing a temporary import surcharge). International trade lawyers shared the sense of alarm in the 1970s; see Robert E. Hudec, "Retaliation Against 'Unreasonable' Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment," *Minnesota Law Review*, 59 (No. 3, 1975).

¹⁰ Robert B. Reich, "Beyond Free Trade," *Foreign Affairs*, 61 (Spring 1983), p. 774.

¹¹ For sophisticated variants, see Jagdish Bhagwati, *The World Trading System at Risk* (Princeton: Princeton University Press, 1991), and Jagdish Bhagwati and Hugh T. Patrick, eds., *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System* (Ann Arbor: University of Michigan Press, 1990). Also see "Echoes of the 1930s," *The Economist*, January 5, 1991.

world money to which national monies would be subordinated and by which they might some day be supplanted."¹² At the level of global monetary relations, however, governments have shown little desire to move in any such "cosmopolitan" direction.¹³ Robert Aliber characterizes a second common tendency as the willingness by commentators to "risk sacrificing the state to save the constitution" – that is, to expect governments to adhere rigidly to rules, no matter what the conditions and no matter what the consequences, even when viable and apparently acceptable alternatives exist.¹⁴ Governments have not eagerly followed that course. The effects of these mindsets are compounded in assessments of the trade regime by the emotive appeal of free-trade ideology among economists and of the written text by international legal scholars.

Our first task, then, is to sketch out the basic institutional framework – the principled and shared understandings by which the capitalist countries sought to come to grips with the twin desires of domestic and international economic stability in their trade relations at the outset of the postwar era. Only then can we discern which practices constitute serious deviation from the norm today, and where fundamental problems reside. The present section comprises two parts. First, I summarize the central features of the embedded liberalism compromise in the postwar trade regime. Then I examine the most significant trade policy practices by governments today which are often characterized as being incompatible with postwar norms. Predictably, one of the main reasons for deviations from past practice is the fact that the United States has developed a more strategic orientation to its trade policy as a result of the resurgence of Europe and Japan, as well as the emergence of entirely new entrants in the tournament of major economic players. From the heterodox vantage of embedded liberalism, however, many of the deviations from past practice do not seem quite as problematical as they do from more conventional points of view. The trade regime is not in danger of imminent collapse as a result of policy practices by the major capitalist economies vis-à-vis one another.

12 Peter Kenan, "An Overall View," in Fabio Basagni, ed., *International Monetary Relations After Jamaica* (Paris: The Atlantic Institute for International Affairs, 1976), p. 7.

13 The European Union is an exception to this generalization. Because this monograph focuses on the posture of the United States vis-à-vis the global trade regime, developments in the EU are referred to only in passing.

14 Robert Z. Aliber, "Fixed Exchange Rates and the Rate of Inflation," in Colin D. Campbell and William R. Dougan, eds., *Alternative Monetary Regimes* (Baltimore: Johns Hopkins University Press, 1986), p. 120.

Embedded Liberalism in Trade

Once negotiations on postwar commercial arrangements got under way seriously, in the context of an International Conference on Trade and Employment, the principles of multilateralism and tariff reduction were affirmed, but so were safeguards, exemptions, exceptions, and restrictions – all designed to protect the balance of payments and a variety of domestic social policies.¹⁵ The proposed charter for an all-encompassing International Trade Organization (ITO) became internally so inconsistent that it is difficult to say what sort of regime it would have given rise to. In any case, the U.S. Senate refused to ratify the charter, it being too intrusive for some and not activist enough for others. As a result, traditional and less controversial concerns of commercial policy – tariffs, quotas, and the like – were incorporated into a General Agreement on Tariffs and Trade (GATT), which the United States helped form upon the ITO's demise and which it joined by executive order.¹⁶ A far smaller domain of commercial relations thereby became subject to the trade regime than would have been the case otherwise. Among the most important exclusions were the regulation of commodity markets, restrictive business practices, and international investments. The fact that multilateral rules for these domains were not created came to pose major problems for the trade regime in later years, as we shall see in the next section.

The GATT made obligatory the most-favored-nation rule, but a blanket exception had to be allowed for all existing preferential agreements (a U.S. concession to Britain), and countries were permitted to form customs unions and free trade areas (U.S. encouragement to Western Europe). Moreover, quantitative import restrictions were prohibited, but were deemed suitable measures for safeguarding the balance of payments – *explicitly* including payments difficulties that resulted from domestic full employment policies. They could also be invoked in agricultural trade if used in conjunction with a domestic price support program. The substantial reduction of tariffs and other barriers to trade was called for, but it was *not* made obligatory and was coupled with appropriate emergency actions which were allowed if domestic producers were threatened with injury from import competition that was due to past tariff

¹⁵ The United States, led by Secretary of State Cordell Hull, initially had pursued a more orthodox free-trade line. Opposition to it was universal abroad and nearly so among New Dealers at home. The split was resolved by delaying the trade negotiations until the monetary agreement was concluded – and Hull had retired. Ikenberry picks up the story: "After the Treasury group succeeded in reaching an agreement with the British on postwar monetary arrangements, the State Department found its nineteenth-century style trade proposals essentially incompatible with these agreements" and fell into line. Ikenberry, "A World Economy Restored," p. 310.

¹⁶ The classic study remains William Diebold, Jr., "The End of the ITO," *Princeton Essays in International Finance*, 16 (October 1952).

concessions. The Agreement also offered a blanket escape from any of its obligations provided that two-thirds of the contracting parties approved – in 1955 the United States availed itself of this opportunity to exclude its agricultural adjustment program from international scrutiny. Lastly, procedures were provided to settle disputes arising under the Agreement and for the multilateral surveillance of the invocation of most (though not all) of its escape clauses. The principle of reciprocity was enshrined as a code of conduct, to guide both tariff reductions and the determination of compensation for injuries suffered.

The efforts to construct multilateral economic regimes did not come to fruition until the late 1950s. Only then had European leaders acquired the confidence to undertake the process of liberalization beyond Europe itself. The European Economic Community had been formed, the International Monetary Fund (IMF) agreements became fully operational, and GATT negotiations began the process that would virtually eliminate tariff barriers to trade and make possible the most sustained period of economic growth ever. Getting from "here to there" required substantial doses of U.S. financial assistance, security assistance, and deliberate discriminatory monetary and trade practices by Western Europe against the United States so as to promote intra-European liberalization. The United States also intervened more directly in the domestic politics of other countries, through the occupation authorities in Germany and Japan, and through such transnational adjuncts of American civil society as the American Federation of Labor, which was particularly active in France, Italy, and Latin America. The U.S. sought, thereby, to moderate the structure and ideological direction of political movements, to encourage the exclusion of communist parties from participation in governments, and generally to keep collectivist impulses within acceptable center-left bounds.¹⁷ Finally, in order to persuade the Europeans to admit Japan into the GATT in the mid-1950s, the United States permitted them to phase in Japan's access to their markets while opening its own market to Japanese goods immediately.

In the process of getting from here to there, the monetary and trade regimes lost the universalism that would have been provided by socialist membership, European and Japanese particularisms were encouraged for the sake of U.S. and allied security objectives, and policies toward the emerging third world became shaped by cold war rivalry.

¹⁷ See Robert A. Pollard, *Economic Security and the Origins of the Cold War* (New York: Columbia University Press, 1985); Alan S. Milward, *The Reconstruction of Western Europe, 1945-1951* (Berkeley and Los Angeles: University of California Press, 1984); Maier, "The Two Postwar Eras;" and Stephen A. Schuker, "Comments on Maier," *American Historical Review*, 86 (April 1981).

Discontinuities or Adaptive Change?

As a result of successive rounds of GATT reductions, tariff levels have been lowered to the point of no longer constituting a barrier to international trade: barely 5 percent on industrial products, down from an average of over 40 percent in the immediate postwar years. As a result, exclusive preferences also became irrelevant, though generalized preferences for developing countries are in place by international agreement.¹⁸ Growth in world trade has averaged in excess of 5 percent per annum throughout the postwar period and continues to outpace growth in world output. During the 1980s, Latin America and Africa were engaged in a decade-long struggle against debt, inflation, stagnation, and capital flight. But overall exports from the developing countries continued to rise, and Latin America has since recovered. Moreover, many developing countries that had stayed out of the GATT, preferring the more statist orientation of the UN Conference on Trade and Development (UNCTAD), have now joined. The former socialist countries uniformly have turned their backs on over forty years of central planning and now seek integration into the world economy. Lastly, the GATT's Uruguay Round, the first to venture into the uncharted terrain of services, intellectual property rights, and agriculture produced an agreement and proposed the creation of a World Trade Organization (WTO), which would have a considerably greater capacity than GATT for dealing with recent trade policy problems.¹⁹

Few observers question the significance of these accomplishments. But many have challenged their sustainability in the face of the forces of the so-called new protectionism, in particular various forms of nontariff barriers imposed by the leading industrialized countries on imports from one another and from the newly industrializing countries. The United States is usually indicted as a chief culprit.

¹⁸ Because of its common external tariff and its special relations with a group of Asian-Pacific-Caribbean developing countries, this generalization does not hold fully for the European Union. As Martin Wolf has put it, the EU "is not only itself a discriminatory trading arrangement, if looked at as a collection of separate countries, but is embedded in concentric circles of discrimination," consisting of a variety of preferences and restraints. Wolf, "The European Community and the Developing Countries in the International Trading System," *Aussenwirtschaft*, 42, Heft 1 (1987), pp. 56-57. These exceptions are perfectly acceptable under existing rules of the game, and make relatively little practical difference to the overall trading system besides.

¹⁹ At the time of writing, the ratification process for the Uruguay Round has yet to begin, hence it is too soon to tell in what forms the new proposals will be enacted and how they will function. One early analysis of the agreement that I have found very useful and draw on below is John M. Curtis and Robert Wolfe, "Nothing is Agreed Until Everything is Agreed: First Thoughts on the Implications of the Uruguay Round," in Maureen Appel Molot and Harald von Rieckoff, eds., *A Part of the Peace: Canada Among Nations, 1994-95* (Ottawa: Carleton University Press, 1994).

The particulars regarding the so-called new protectionism on the part of the United States are not in dispute. The primary referent is various forms of administered and negotiated nontariff barriers to imports, above all escape clause relief, antidumping and countervailing duty actions, and voluntary export restraints. What is at issue is what these practices signify. The first two have explicit legal bases in GATT, though their implementation may deviate in specific instances. The last is nowhere mentioned in GATT, but that fact alone does not make it incompatible with GATT norms. The incidence of these measures has increased substantially over the years, especially in the 1980s, but so did trade liberalization. Even when these practices are not abused they reduce trade flows below what their levels would be in an unrestricted commercial world, but neither the U.S. government nor any other has ever agreed to live in such a world. In addition to "process protectionism," some observers have also expressed concern about a resurgence of "legislated protectionism" by Congress, pushing the executive branch to pursue tougher unilateral trade remedies.²⁰ Yet Congress, at the same time, has refrained from reclaiming the full trade policy powers it first started to delegate to the executive in the mid 1930s – largely to facilitate liberalization, as well as to protect itself from protectionist pressures. In short, we find ourselves in the messy business of interpretation. The institutional framework of embedded liberalism, not textbook orthodoxies, serves as our baseline.

The "New Protectionism"

Serious tariff reductions began with the GATT's Kennedy Round in the 1960s. There is considerable evidence that, right from the start, movement toward greater economic openness in the OECD countries has been closely associated with governments expanding their domestic role to manage the adjustment costs. What is more, openness overrides virtually all other economic and political factors in explaining governments' active policy roles – including economic size, level of affluence, rate of unemployment and the presence of left-wing parties in the electoral system.²¹ Lastly, as one such study concluded, governments on the whole "merely attempt to mitigate the negative effects of trade liberalization on specific industries and not to offset them entirely."²² Though governments had never defined a precise metric, in terms of

20 The terms process and legislated protectionism are employed by I.M. Destler in what has become the standard study of U.S. trade policy, *American Trade Politics*, 2nd. edition (Washington, D.C.: Institute for International Economics, 1992), chap. 6.

21 David R. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review*, 72, No. 4 (December 1978), p. 1254, may have been the first study to demonstrate this relationship statistically.

22 André Blais, "The Political Economy of Public Subsidies," *Comparative Political Studies*, 19, No. 2 (July 1986), p. 210.

the overall balance of international and domestic objectives, as we have seen, this is more or less how the trade regime was expected to function.

The United States differs from other industrialized countries in its size, the relatively modest share of trade in its national product, and the more liberal character of its state. Accordingly, it has relied more heavily on external as opposed to internal adjustment mechanisms.²³ But the pattern is similar and its markets are among the most open. Judith Goldstein shows that "[a]s tariffs decreased and imports increased their market share in the 1960s and 1970s, American producers did react by petitioning the bureaucracy for protection."²⁴ Nevertheless, the government's response did *not* simply mirror the increased petition activity. "When confronted by a choice between giving aid or not, the executive gave no aid. When protectionism was mandated by the bureaucracy, the president often chose to give a transfer payment, to give less than recommended or, in the case of countervailing duties, to sanction a tariff waiver. In dumping findings, legislation leaves no recourse but to assess a duty. However, every effort was made to convince the exporter to halt the practice."²⁵ Voluntary export restraints (VERs), negotiated directly with the exporting country, became the instrument of choice for the executive branch to avoid mandated actions. But while the U.S. government thereby may have provided adversely affected domestic industries with many things, Goldstein concludes, "effective protection" was not one of them.

In the 1970s, Congress twice changed the rules to make it easier for import-affected industries to obtain trade relief: in 1974, as part of legislation authorizing U.S. participation in the GATT's Tokyo Round, and in 1979, in legislation approving the liberalizing results of that Round. Many more petitions were filed thereafter. "But in terms of actual relief granted, industry petitioners were again to be disappointed."²⁶ So the rough balance continued to hold.

- 23 The impact of size on state structure and corresponding policy tools vis-à-vis the international economy are spelled out by Peter J. Katzenstein, "The Small European States in the International Economy: Economic Dependence and Corporatist Politics," in John Gerard Ruggie, ed., *The Antinomies of Interdependence* (New York: Columbia University Press, 1983). For a comparative study of the correlates of nontariff barriers which reaches similar conclusions using 1980s data, see Edward D. Mansfield and Marc L. Busch, "The Political Economy of Nontariff Barriers" (forthcoming).
- 24 Judith Goldstein, "The Political Economy of Trade: Institutions of Protection," *American Political Science Review*, 80 (March 1986), p. 169. This is a comprehensive analysis of all statutory restraints imposed by the United States since the 1950s. Also see Goldstein, "Ideas, Institutions, and American Trade Policy," in G. John Ikenberry, David A. Lake and Michael Mastanduno, eds., *The State and American Foreign Economic Policy* (Ithaca, NY: Cornell University Press, 1988), p. 169.
- 25 Goldstein, "Political Economy of Trade," p. 180.
- 26 See Destler, *American Trade Politics*, chap. 6, for a discussion of these changes; the quote is from p. 145.

The instrumentalities of relief, however, shifted. The use of the most difficult-to-prove, injury under the escape clause provision, began a steady decline in the late 1970s, the government in many instances moving directly to negotiate VERs with the exporting country. In contrast, antidumping and countervailing duty cases, in which the criteria are vague, more arbitrary, and thus easier to meet, began a steady climb. Trade adjustment assistance to labor was also enhanced in the 1970s. But the United States – as a liberal welfare state, in Mary Ruggie's terminology²⁷ – lacked a sufficiently active labor market policy to make that provision succeed. It was significantly reduced by the Reagan administration.

The stagflation of the Carter years put great pressure on the trade relief system in the United States. But during the early Reagan years, the proverbial "all hell broke loose." William Niskanen, a member of the Reagan Council of Economic Advisers and a strong defender of the administration's overall economic program, summarizes the episode in these terms:

Trade policy in the Reagan administration is best described as a strategic retreat. The consistent goal of the president was free trade, both in the United States and abroad. In response to domestic political pressure, however, the administration imposed more new restraints on trade than any administration since Hoover.²⁸

The domestic political pressure, in turn, had two main sources. The first was the consequences of the administration's own macroeconomic policies. The value of the U.S. dollar appreciated by nearly 60 percent in real terms from 1981 to 1985. Not surprisingly, imports surged during the same period, from 18.9 percent to 25.8 percent of total U.S. goods production, and exports plummeted by "a drop nearly as great as that precipitated fifty years earlier by the Great Depression and the Smoot-Hawley Act."²⁹ The resulting trade deficit dwarfed all previous peaks. "Not only was this imbalance unprecedented for modern America; it was the worst imbalance experienced by any advanced industrial nation since the 1940s."³⁰ It is virtually axiomatic that trade relief measures should have exploded to equally unprecedented levels. For a brief time new trade impediments actually may have out-weighted market opening trends.

27 On the differences between liberal, social democratic, and neo-corporatist forms of welfare states, see Mary Ruggie: *The State and Working Women* (Princeton: Princeton University Press, 1984); "The Paradox of Liberal Intervention," *American Journal of Sociology*, 97 (January 1992); and *Realignments in the Welfare State* (forthcoming).

28 William A. Niskanen, *Reaganomics* (New York: Oxford University Press, 1988), p. 137.

29 Destler, *American Trade Politics*, p. 201.

30 Ibid., p. 200.

The second source was more directly electoral in nature. The Reagan imbalances created vast opportunities for entrepreneurial politicians of both parties to build electoral support on platforms of "fair trade rules" and "level playing fields" to protect American industries and jobs from "unfair" foreign competition. When the Democrats regained control of the Senate in 1986, this general political mode took on a distinct partisan tint as well. A president from the other party who seemed invincible in so many other respects was exceedingly vulnerable on the trade issue. The trade bills that emerged in the House and Senate "threatened the most substantial reversal of U.S. trade law since the United States took the lead in rebuilding the world trading system in 1934."³¹ And yet, the Omnibus Trade and Competitiveness Act of 1988 that was finally passed into law veered off that course – perhaps aided by Wall Street's "Black Monday," when the Dow Jones Industrial Average went into a 500 point free-fall. The Act "did not impose statutory protectionism, and it did not impose direct congressional control over trade."³²

Indeed, a reversal had already begun to set in, first in monetary policy, then in the trade imbalance and corresponding requests for relief. Former International Trade Commission (ITC) chair Paula Stern describes the situation by the late 1980s:

less than 1 percent of total U.S. imports were actually challenged as unfair under U.S. trade laws. The volume of U.S. imports affected by antidumping and countervailing duty investigations as a percentage of total imports amounted to only 0.2 percent in 1987, 0.4 percent in 1988, and 0.2 percent during the first half of 1989. Even in the cases where the [ITC] and Department of Commerce (DOC) made affirmative determinations, the average dumping duty applied in 1987 on dumped or subsidized goods was 1.2 percent. In 1988, the average was 3.7 percent; in the first half of 1989, the figure was 1.4 percent.³³

Destler draws up a similarly judicious assessment for the decade as a whole: "the most reasonable conclusion is that American trade protection increased sharply in the early 1980s but receded somewhat thereafter. The net increase over the decade was less than one might have expected given the pressures at

³¹ Niskanen, *Reaganomics*, p. 150. Among them was the infamous "Gephardt amendment" introduced by the Democratic Representative from Missouri, whose presidential bid featured neoprotectionism. If adopted, the amendment would have imposed import quotas on countries running large bilateral surpluses with the United States. It was eventually replaced by the Super 301 provision (see below).

³² Destler, *American Trade Politics*, p. 95.

³³ Paula Stern, "Commentary," in Bhagwati and Patrick, *Aggressive Unilateralism*, pp. 192-193.

play."³⁴ Congress also approved the North American Free Trade Agreement (NAFTA) in 1993; the Uruguay Round accord awaits Congressional action.

In short, the evolution of U.S.'s "new protectionism" has not undermined continued liberalization; on the whole, the two have proceeded in parallel. One major exception was a byproduct of the unusual conjunction of economic forces and policies during the early Reagan years. Another, less striking exception is the tendency by the U.S. to adopt external adjustment mechanisms because of its unwillingness or inability to institute certain domestic mechanisms. The reduction of trade adjustment assistance to labor is a case in point; it has made organized labor in the United States an implacable foe of liberalization and a ready ally in coalition politics for trade protection – with potentially high costs, as revealed in the NAFTA debate when labor joined forces with major environmental groups to oppose the treaty. Similarly – and with greater justification – the U.S. opposes "industrial targeting," and "industrial policy" more generally. The U.S. political system cannot agree to institute such practices, variants of which are widely pursued abroad, but nor can it simply afford to ignore the combined forces for emulation (sought by labor, for example) and retaliation (sought by import-sensitive industries). The tension was resolved in the 1988 trade legislation by declaring the practice "unreasonable" and subject to retaliatory action.³⁵

Even apart from these anomalies, the longer-term vulnerability of the system has also become apparent, underscoring the need for more robust multilateral rules to govern nontariff barriers.³⁶ The Uruguay Round accord contains new provisions regulating countervailing duties, antidumping, and the invocation of safeguards, as well as new dispute settlement procedures.³⁷ Of course, it remains to be seen how effective these will be in practice.

Managed Trade

The embedded liberalism baseline permits us to differentiate between such instruments as VERs, antidumping and countervailing duty actions, on the one

³⁴ Destler, *American Trade Politics*, p. 207.

³⁵ As Destler points out (pp. 161-165), the latter provision was actually a victory for restraint because it began as a bill to legislate protection.

³⁶ One perverse feature of the current system is the vast legal and lobbying services industry it has generated; legal fees for the steel sector alone in 1992 were predicted to exceed \$100 million. See Keith Bradsher, "Trade Gap Too High? Export a Few Lawyers," *New York Times*, July 2, 1992, p. D1. The deterrent effects – or anticipated rewards – of these legal and lobbying activities themselves skew the incentives of producers, which economists are beginning to model. See Michael P. Leidy, "Trade Policy and Indirect Rent Seeking: A Synthesis of Recent Work," *Economics & Politics*, 6 (July 1994).

³⁷ Curtis and Wolfe, "Nothing is Agreed Until Everything is Agreed."

hand, and more pernicious forms of "managed trade," on the other. Two differences stand out. First, most instruments of the co-called new protectionism do not seek to fix bilateral or overall market shares, but to slow down or limit the rate of increase in imports in the attempt to give domestic industry time to adjust to new competitive environments. Under "managed trade," however, governments go well beyond cushioning the burden of adjustment. They negotiate or otherwise set market shares. The controversial side-letter to the 1986 semiconductor agreement between the United States and Japan, which seemed to promise U.S. exporters a 20 percent share of Japan's domestic market within a five-year period, is a case in point. Another is the Multifibre Arrangement – a vast web of bilateral quotas indicating who can sell how much of which textiles and apparel to whom – though at U.S. initiative, governments in the Uruguay Round agreed to phase it out. The proposed U.S.-Japan autoparts deal that gave President Bush such grief on his 1992 Tokyo visit would have been another instance, as would the numerical targets for market opening the Clinton administration initially sought from Japan, which were later watered down to seeking "objective criteria" for measuring progress toward that end.

Second, in most instances the instruments of the "new protectionism" are not permanent features of the trading landscape. As Aggarwal and his colleagues demonstrate, different arrangements exhibit different temporal patterns reflecting, among other factors, industry structure.³⁸ The authors suggest that temporary restraints are characteristic of small industries with low barriers to entry and exit. In the face of foreign competition, domestic firms use the adjustment period afforded by the restraints to take their money and run. Restraints on color television and footwear imports into the U.S. provide examples. Longer-term institutionalized barriers are found, they suggest, in labor-intensive industries with low barriers to entry but high barriers to exit. Here firms are politically important and stuck. The Multifibre Arrangement, a prime instance of managed trade, illustrates this pattern. Finally, sporadic restraints tend to occur in industries characterized by large firms, high entry barriers but also high adjustment or exist costs. In the cases of steel and automobiles, for example, firms should have used the opportunity afforded by restraints to adjust earlier, but for a variety of reasons they did not, obtaining renewed protection instead. Adjustment finally did come about and the restraints were removed. Managed trade arrangements, in contrast, are more likely to remain in place for a longer duration. This is so because they tend to freeze in market shares, increase cartelization, and lower long-term competitiveness. Moreover, they are far more susceptible than the "new protectionism" to the broad and complex array of political pork-barreling and bureau-

38 Vinod K. Aggarwal, Robert O. Keohane, and David B. Yoffie, "The Dynamics of Negotiated Protectionism," *American Political Science Review*, 81 (June 1987).

cratic inanities – such as the U.S. insisting, purely as a byproduct of internal negotiating tradeoffs, on limiting the import of cotton diapers under the Multifibre Arrangement even though the entire U.S. industry at the time consisted of one plant with 60 employees.³⁹

Once these differences are spelled out, it becomes clear that managed trade remains, by many orders of magnitude, the exception to the rule.

Coercive Discrimination

Let us turn next to the allegedly coercive and discriminatory treatment that VERs in particular are said to impose. Exporters typically act under the threat of worse to come if they fail to reach agreement with the importing country. U.S. trade negotiators, for example, have frequently threatened to turn Congress loose on Japanese exports – hence the accusation that this practice constitutes coercion if not outright relapse to the rules of the jungle. Two counterarguments come to mind.

First, because VERs limit the volume of an import its value often rises.⁴⁰ Thus, the scarcity rents produced by government intervention in the importing country is transferred to the *exporter* – and is paid by consumers in the *importing* countries. Paying off exporters at the expense of one's own consumers is an odd form of international coercion – indeed, so odd that Japanese automobile manufacturers decided unilaterally to impose such an arrangement on themselves as they shifted their efforts in the U.S. market from selling medium-priced models to capturing the luxury market from European exporters. In other cases, a secondary market in quotas has actually emerged, complete with quota brokers; the markets for textile quotas in Hong Kong, South Korea and Taiwan are cases in point. The current costs of these practices to U.S. consumers per job saved are so high that rationalization in some form is inevitable.⁴¹ By means of information exchange and systematic trade policy reviews, the "trade policy review mechanism" adopted during the Uruguay Round should make these costs far more transparent.

Second, those who charge coercion typically ignore the fact that not only the threatened unilateral but even the existing *multilateral* alternative to VERs

³⁹ Lindley H. Clark, Jr., "How 'Managed Trade' Would Really Work," *Wall Street Journal*, November 9, 1989.

⁴⁰ This feature of VERs was pointed out long ago by David Yoffie, *Power and Protectionism* (New York: Columbia University Press, 1983).

⁴¹ See Gary Clyde Hufbauer and Kimberly Ann Elliott, *Measuring the Costs of Protection in the United States* (Washington, D.C.: Institute for International Economics, 1994). The estimate for 1990 alone was \$70 billion; in 21 sectors studied, estimates of the per-job-saved cost ranged from \$100,000 to \$1 million.

would leave the exporter *worse off* than VERs do. As Brian Hindley has pointed out, "for most countries confronted with a request for a VER, the alternative, should they refuse, is not unrestricted trade but an Article XIX emergency action [under the GATT]. In that event, the exporting country will find itself faced with a tariff on its exports or by formal quota restrictions on them with the quota rights going to importers... rather than to exporters. In either case, the profits of the exporting industry will be reduced..."⁴² What is more, unlike the case of VERs, there is no effective time limit on how long Article XIX safeguards may remain in force; as noted above, VERs generally do have such a limit at the end of which they either expire or must be renegotiated. Finally, no country claiming injury under Article XIX has ever had its claim challenged. In any practical as opposed to purely rhetorical sense, therefore, the charge of coercion is specious: the exporting industry typically gets a better deal under VERs than it would under the legally prescribed, multilateral alternative.

The charge of discrimination is somewhat more complex. That these practices are discriminatory cannot be questioned; it is the very reason they are invoked. The real issue, however, is whether VERs or the legally permissible alternative, again an escape clause action under Article XIX, do more collateral damage to the trade regime. And it is not obvious that Article XIX should be preferred on those grounds, because in principle it should be applied in a nondiscriminatory manner, thereby adversely affecting innocent bystanders. The retort that escape clause action under Article XIX nevertheless should be preferred on principle, because VERs are not sanctioned by GATT and are, thus, technically illegal is a perfect example of what Aliber describes as "sacrificing the state to save the constitution." No rational government can be expected to follow the precept when well established acceptable alternatives are available. Besides, the term "illegal" itself is highly problematical in this context. "A much better analogy is the out-of-court settlement of civil legal actions," Hindley suggests, "a procedure whose outcome is constrained by the law, but which both parties to the dispute expect will leave them better-off than undergoing the expenses of the full judicial process. No legal system will collapse as a result of such agreements (on the contrary, if there were no such agreements, collapse would be very much more likely)."⁴³

⁴² Brian Hindley, "Voluntary Export Restraints and GATT's Main Escape Clause," *The World Economy*, 3 (November 1980), p. 321; for more recent econometric confirmation, see Yoshiyasu Ono, "Orderly Marketing Arrangement in the Context of the GATT Regime," *Economics & Politics*, 3 (July 1991).

⁴³ Hindley, "Voluntary Export Restraints," pp. 331-332. Demonstrating how refined this system has become – and underscoring the efficacy of Hindley's analogy – several U.S. VERs on steel imports have included "short supply" provisions, whereby domestic consumers of steel could petition the Commerce Department for additional imports if they had difficulty obtaining sufficient supplies from domestic producers. Adding irony to

Thus, in practical as opposed to rhetorical or legalistic terms, the charge that VERs are coercive is specious, while their discriminatory nature probably has helped preserve the broader trade regime rather than undermining it.

Aggressive Unilateralism

We come, finally, to a recent tendency in U.S. trade policy that critics have labeled "aggressive unilateralism."⁴⁴ If interwar bilateralism was the evil that energized the creation of the postwar multilateral trade regime, then unilateralism must be even more noxious, especially unilateralism of an aggressive kind. The chief culprit here is the amended Section 301 of U.S. trade legislation, especially the so-called Super 301. Whereas Regular 301 targets "unfair" trade practices, Super 301 lists target countries and mandates timely action by the executive branch. Under these provisions the U.S. assumes the right to act as accuser, judge, and jury in assessing which trading practices by others are unfair, and to impose punishment on those it finds guilty. The practice is clearly GATT-illegal, even under the creative criteria for "justified disobedience" that Hudec has devised.⁴⁵

One of the justifications for Section 301 measures that even critics have trouble refuting is that GATT processes for dealing with "unfair" trade practices and restraints are exceedingly clumsy, slow, difficult to prove, and even harder to settle, while the prospects for reforming them in the absence of external pressure have seemed low. The U.S.'s trading partners, understandably, have never liked Section 301, even before the "Super" version was introduced. But the only comprehensive empirical study of its actual effects in fact shows that, not only has Section 301 been tolerated abroad, it has also had a net liberalizing effect on world trade.⁴⁶ In any event, WTO institutional reforms may alleviate some of the remaining problems.

complexity, at one point the Congressional Steel Caucus – consisting of representatives from steel-producing states – became concerned that Commerce was not acting in a sufficiently timely manner on such short supply petitions, and asked the General Accounting Office to investigate. By creating what amounted to a safeguards provision on a safeguards provision, the Caucus was eager to signal sensitivity to major domestic industries that use steel as an input, hoping to reduce their opposition to the VERs. United States General Accounting Office, "International Trade: Administration of Short Supply in Steel Import Restraint Agreements," Statement of Allan I. Mendelowitz, GAO/T-NSIAD-89-35, May 23, 1989.

44 The term is due to Bhagwati and Patrick, *Aggressive Unilateralism*.

45 Hudec, "Thinking about the New Section 301," in *ibid*.

46 Thomas O. Bayard and Kimberly Ann Elliott, *Reciprocity and Retaliation: An Evaluation of Aggressive Trade Policies* (Washington, D.C.: Institute for International Economics, 1994). These unilateral means have produced multilateral outcomes in the past. The original Section 301 of the Trade Act of 1974 "encouraged the United States to make greater use of the GATT dispute settlement process. ... [O]f the sixteen GATT

The reason for Super 301 can be simply put: Japan. Even though the amendment is expressed in universalistic language and three "unfair" traders were identified in its first year of operation, it would not have been adopted were it not for Japan.⁴⁷ Specifically, the provision was animated by a growing consensus in U.S. political circles that Japan's domestic structures, policies, and practices have kept Japan's market relatively sheltered against foreign competition while boosting Japan's exports, thereby contributing to the high and seemingly permanent bilateral trade imbalance in favor of Japan.

U.S. debates of Japan's trade practices and industrial organization are often politically and even emotionally charged. On one side are alleged Japan-bashers, on the other the so-called Chrysanthemum club. Periodic outbursts of racist commentary occur in both countries. When all else is stripped away, however, there is one dimension of Japan's trade flows that stands apart from the other major industrialized economies: its relatively low levels of intra-industry trade. Yet intra-industry trade has been a privileged area for trade liberalization by the industrialized countries. Therefore, Japan's difference produces political friction, no matter what its causes may be.

A generation ago, neoclassical theory still viewed intra-industry trade as being socially less profitable than inter-industry trade, all other things being equal.⁴⁸ But governments in successive GATT rounds have encouraged the liberalization precisely of intra-industry rather than inter-industry trade. As a result, specialization has been achieved not by countries abandoning entire industrial sectors, but "mainly by individual firms narrowing their product lines."⁴⁹ There are, of course, straightforward economic reasons why intra-industry trade among the major industrialized countries should have grown throughout the postwar era, having to do with similarities of production structures, the existence of scale economies, and satisfying consumers' preferences for variety. But there were also strong political reasons for governments in those countries to have encouraged such trade: the domestic social and political adjustment costs of intra-industry trade are lower because whole segments

complaints filed by the United States between 1975 and 1985, eleven complaints arose out of section 301 investigations." Julia Christine Bliss, "GATT Dispute Settlement Reform in the Uruguay Round: Problems and Prospects," *Stanford Journal of International Law*, 23 (No. 1, 1987), p. 45. The fear that Japan's market opening in response to U.S. unilateral pressure may be limited largely to U.S. firms is expressed by an Australian academic, Aurelia George, "Japan's America Problem: The Japanese Response to U.S. Pressure," *The Washington Quarterly*, 14 (Summer 1991).

⁴⁷ Brazil and India were also named in the initial U.S. review, largely for tactical reasons.

⁴⁸ See Richard N. Cooper, *The Economics of Interdependence* (1968; New York: Columbia University Press, 1980), esp. pp. 75-76.

⁴⁹ Richard Blackhurst, Nicolas Marian, and Jan Tumlrir, "Trade Liberalization, Protectionism and Interdependence," *GATT Studies in International Trade*, 5 (November 1977), p. 11.

of producers and the work force are not threatened by it, and yet it offers gains from trade. In a word, the liberalization of intra-industry trade is more compatible with the political economy of the embedded liberalism compromise.

This puts the "Japan problem" in a somewhat clearer light. As Edward Lincoln documents, Japan tends to import least precisely in those areas in which it exports most, so that its level of intra-industry trade is at or near the bottom in virtually every industrial sector.⁵⁰ Granted, Japan is resource-poor and needs, therefore, both to import raw materials and to export manufactured products to pay for those imports. Even so, Japan has exhibited a much stronger preference than other resource-poor industrialized countries for entirely unprocessed or the simplest refined forms of raw materials imports. And on the manufactured exports side, Japan exhibits a far greater level of export concentration in selected high value-added products than its competitors. Finally, while the lowering of formal trade barriers, according to both theory and the historical experiences of other industrialized countries, should have led to the erosion of this pattern, it has not.⁵¹

The "Japan problem," then, is not a matter of Japan cheating on the formal GATT rules. Japan's tariffs are low, its quotas are few, and its outright rule violations are less frequent than many other industrialized countries. The structure of Japan's trade is simply, but importantly, different from the established behavioral norm around which the trade regime has come to revolve. It is this difference that has led even non-Japan-bashers to single out Japan's trading pattern as "adversarial."⁵²

⁵⁰ See Edward J. Lincoln, *Japan's Unequal Trade* (Washington, D.C.: The Brookings Institution, 1990). There is another side to this argument: see, for example, Gary R. Saxonhouse, "Comparative Advantage, Structural Adaptation, and Japanese Performance," in Takashi Inoguchi and Daniel I. Okimoto, eds., *The Political Economy of Japan* (Stanford: Stanford University Press, 1988); and Gary R. Saxonhouse and Robert M. Stern, "An Analytical Survey of Formal and Informal Barriers to International Trade and Investment in the United States, Canada, and Japan," in Robert M. Stern, ed., *Trade and Investment Relations Among the United States, Canada, and Japan* (Chicago: University of Chicago Press, 1989). Judicious assessments may be found in Paul Krugman, ed., *Trade With Japan: Has the Door Opened Wider?* (Chicago: University of Chicago Press, 1991); and John Ravenhill, "The 'Japan Problem' in Pacific Trade," in Richard Higgott, Richard Leaver, and John Ravenhill, eds., *Pacific Economic Relations in the 1990s: Cooperation or Conflict?* (Sydney: Allen and Unwin, 1993).

⁵¹ Lincoln, *Japan's Unequal Trade*. Also see John Ravenhill, "The 'Japan Problem' in Pacific Trade."

⁵² "In adversarial trade the seller's goods displace the goods produced by the manufacturers of the buying country without any compensating purchases from that country." Peter Drucker, "Japan and Adversarial Trade," *Wall Street Journal*, April 1, 1986. Paul Krugman, in an article explaining why Japan is not the major cause of America's economic woes, nevertheless notes that "Japan is a great economic power that does not

This issue is not without irony because in some sense Japan appears merely to be "follow[ing] the principle of comparative advantage," as the *Economist* notes approvingly.⁵³ Policymakers in its trading partners are less sanguine, however. Leave aside the thorny questions of why Japan exhibits the pattern of trade it does and how it is sustained. Whatever its causes, the result is that Japan poses serious political problems for other governments: "The fact that intra-industry trade has become a normative pattern of behavior for other countries means that Japan's failure to conform imposes adjustment costs on the industries of other countries that they do not expect to bear."⁵⁴ It also imposes costs on governments as they struggle to deal with pressure from affected domestic industries. In no sector is this challenge perceived to be of greater economic and political importance than in high-technology industries, the cutting edge of future economic performance.⁵⁵

Returning to Super 301, then, this provision may be seen as an attempt by the United States to devise a tit-for-tat strategy vis-à-vis Japan intended to induce Japan to change its trade pattern, premised on the assumption that Japan's domestic economic structure contributes to that pattern.⁵⁶ In the event, Japan was not moved to retaliate against the United States when targeted by Super 301, or even to bring action within GATT. Though Japan refused to negotiate formally under Super 301, it sought to defuse the issue by reaching several accords with the U.S. under the so-called Structural Impediments Initiative (SII) – one of the more successful in the long and continuing series of U.S.-Japan trade talks.⁵⁷

play by the same rules as the other great economic powers." Krugman, "Japan is Not Our Nemesis," *New Perspectives Quarterly*, 7 (Summer 1990), p. 44.

53 "Japan's troublesome imports," *The Economist*, January 11, 1992, p. 61; and "Trade made the ship to go," in the same issue, pp. 11-12.

54 Lincoln, *Japan's Unequal Trade*, p. 60.

55 Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High-Technology Industries* (Washington, D.C.: Institute for International Economics, 1992), addresses the mix of trade and industrial policy issues posed by these industries. As chair of the Clinton administration's Council of Economic Advisors, she presumably also affords insight into current U.S. policy.

56 Such an approach was proposed by Stephen D. Krasner, *Asymmetries in Japanese-American Trade: The Case for Specific Reciprocity* (Berkeley: Institute of International Studies, University of California, 1987). The seminal work on the tit-for-tat strategy as an inducement to cooperation is Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984).

57 For a good survey of recent bilateral trade negotiations between the two countries, see Merit E. Janow, "Trading with an Ally: Progress and Discontent in U.S.-Japan Trade Relations," in Gerald C. Curtis, ed., *The United States, Japan, and Asia* (New York: Norton 1994). Super 301 expired in 1990, but President Clinton reactivated it by executive order in 1994 after ongoing talks with Japan broke off and prior to submitting the Uruguay Round agreement to Congress – no doubt hoping to pre-empt tougher

Hudec has made the provocative and potentially productive suggestion that America's trading partners should hold the U.S. accountable to its own new 301 standards, in the attempt to increase the demand for collectively legitimated "fair trade" mechanisms.⁵⁸ Indeed, a 1992 report of an industry advisory council to Japan's Ministry of International Trade and Industry (MITI) did accuse the U.S. of committing nine types of unfair trade practices. Being new at this game, the Japanese outdid even the U.S. Congress in hyperbole, accusing the U.S. of being "the most unfair" trading nation of them all. But the real intention, a MITI official quickly added, "is to use GATT more frequently" in the hope of devising a workable definition of fairness.⁵⁹ That in itself constituted a major concession by Japan, which had never before acknowledged fairness to be an issue.

Conclusion

Let us step back now, and assess the overall configuration of the trade regime today. To begin with, despite proliferating instruments of the "new protectionism," the markets of the industrialized countries are more open than ever before. This anomaly has led the distinguished international economist, Jagdish Bhagwati, to puzzle why "the growth of protectionism appears significant but its consequences do not."⁶⁰ Within the embedded liberalism framework, however, there is no anomaly to begin with: the bulk of the so-called new protectionism may be seen, instead, as a predictable institutional adaptation to continued liberalization in very different international competitive environments than existed in the past.

At the same time, there can be little doubt that the formal instruments of the trade regime have become weaker over time. For example, in its entire history GATT has taken up just over 200 cases under the dispute settlement procedures of Articles XXII and XXIII. That number that was matched by U.S. unilateral antidumping and countervailing duty cases in their peak year of 1982.⁶¹ Because the executive branch typically used its discretionary authority to minimize giving protection, Congress gradually restricted, though it has never sought to eliminate, the range of discretion. Delicate maneuvering be-

Congressional action. Thomas L. Friedman, "Clinton to Reinstate Power to Move Fast on Japan Sanctions," *New York Times*, March 2, 1994, p. A1.

⁵⁸ Hudec, "Thinking About the New Section 301."

⁵⁹ James Sterngold, "Japan is Trying New Approach in Trade Battles," *New York Times*, June 8, 1992, p. A1.

⁶⁰ Jagdish Bhagwati, *Protectionism* (Cambridge, Mass.: MIT Press, 1988), p. 56.

⁶¹ The GATT figure is taken from Dan Kovenock and Marie Thursby, "GATT, Dispute Settlement and Cooperation," *Economics & Politics*, 4 (July 1992); the U.S. figures from Destler, *American Trade Politics*, Table 6.1, p. 166.

tween the two branches of government turned into an avalanche of trade protection in the early to mid-Reagan years. But by the late 1980s, the situation had begun to turn back to a more stable equilibrium.

Moreover, the domestic political coalitions of U.S. trade policy are changing in subtle but significant ways, which promise to help contain future protectionism. The One Hundredth Congress (1987-88) voted on more trade legislation than any other in the postwar era. A recent analysis of those votes reveals several instructive patterns.⁶² The effects of divided government (partisanship) were evident, a traditional protectionist coalition remained influential in the House, and conventional "free" trade retained little support beyond the Republican party. Substantial clusters of "fair" trade and "strategic" trade advocates had also emerged. However, they "are not simply protectionists in disguise."⁶³ Indeed, they opposed protectionism, they were more likely to be liberals, and to received financial support from internationally-oriented business. If there was an overall winner, the study concludes, it was this new "fair" trade coalition.

In addition, the Uruguay Round provisions for nontariff barriers, once enacted, should also arrest some of the longer-term erosion in the rules of the game. Its provisions for agriculture and investment, though only a beginning in extending multilateral trade rules to these domains, also appear to reflect the familiar balancing of international and domestic objectives.⁶⁴ And the Uruguay Round accord is uniformly applicable to all parties – even without the bond that bipolarity had provided the Western capitalist countries in the past. This differs significantly from the Tokyo Round, whose "minilateral" codes for nontariff barriers held only for countries that specifically agreed to sign them, thus producing a more fragmented trade regime – a development realist political economists at the time attributed to declining American hegemony.⁶⁵

⁶² Stanley D. Nollen and Dennis P. Quinn, "Free Trade, Fair Trade, Strategic Trade, and Protectionism in the U.S. Congress, 1987-88," *International Organization*, 48 (Summer 1994).

⁶³ *Ibid.*, p. 518.

⁶⁴ This case is made by Robert Wolfe, "Opening Up the Green Box: Why Agriculture Dominated the Uruguay Round," paper prepared for presentation to the International Studies Association, Acapulco, Mexico, March 1993; and by the same author, "Does Embedded Liberalism Endure? Some Evidence from the Uruguay Round Negotiations on Investment" (Kingston, Ontario: Center for International Relations, Queens University, n.d.).

⁶⁵ See Stephen D. Krasner, "The Tokyo Round: Particularistic Interest and Prospects for Stability in the Global Trading System," *International Studies Quarterly*, 23 (December 1979).

Finally, changing industry preferences promise to reinforce equilibrating tendencies. All economies, including the American, have become more internationalized. Export-dependent industries and multinational firms more generally are less likely to demand protection even if they are under pressure from import competition in a specific sector. To the extent that they seek trade policy relief from their governments, it is more likely to be for securing access to markets abroad. Some of the most advanced industrial sectors, including semiconductors, commercial aircraft, and telecommunications, exhibit this pattern.⁶⁶ The net effect of such pressure for what is sometimes called "voluntary import expansion" should be liberalizing. However, if it were to result in negotiated market shares, as in the U.S.-Japan semiconductor side-letter, then it would increase the incidence of managed trade, which violates both the spirit and letter of postwar norms.

In sum, the postwar trade regime was designed to achieve progressive liberalization internationally, without, however, subordinating domestic stabilization to external strictures; and to allow for and even facilitate governmental intervention in the domestic economy, without, however, triggering the mutually destructive consequences of the interwar period. This traditional stabilization problem has been managed, with exceptions noted above, about as well as can be expected in a world of sovereign states. Indeed, they do not deserve the disproportionate share of attention they continue to receive in academic and policy circles. Far more vexing problems have emerged in recent decades, which pose far more fundamental challenges to prevailing policy instrumentalities, institutional frameworks, and even to organizing concepts and theories than the practices of the new protectionism.

⁶⁶ See Helen V. Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton: Princeton University Press, 1988); Helen V. Milner and David B. Yoffie, "Between Free Trade and Protectionism: Strategic Trade Policy and a Theory of Corporate Demands," *International Organization*, 41 (Spring 1989); and Stephen Engelberg, with Martin Tolchin, "Foreigners Find New Ally is U.S. Industry," *New York Times*, November 2, 1993, p. A1.

II. Institutional Transformation

Due in part to the successes of the postwar trade and monetary regimes, point-of-entry barriers to international economic transactions have been virtually eliminated, financial markets are globally integrated, and entire sectors of production have become thoroughly transnationalized. This transformation in the world economy has had significant positive welfare effects. But it is also severely straining the constitutive premises and institutional foundations of the postwar economic regimes, and of national economic policymaking as well. To try and squeeze these issues into the conceptual containers of liberalism vs. protectionism, however, as many observers are prone to do, misconstrues them seriously. In this section, we examine this transformation and the challenges it poses for the governance of international trade relations.

Contested Domestic Domains

It was no secret to economists in the 1930s that imperfect competition, and patterns of domestic industrial organization more generally, produced significant effects on international trade.⁶⁷ Articles 46-54 of the Charter of the International Trade Organization reflected these concerns, as they sought to curtail a variety of restrictive business practices that might shape trade flows. By virtue of Article 46, for instance, members of the ITO would have pledged "to prevent... business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade..."⁶⁸. In the immediate postwar years, these concerns were removed from the international trade agenda by a two-step process. The first was the defeat of the ITO in the U.S. Senate, which left conventional point-of-entry barriers as the portfolio of the quickly-assembled GATT. Second, GATT then avoided the related conceptual problems posed by state-trading nations, such as the Soviet Union, by calling for state-trading enterprises in their external purchases and sales simply to behave like private economic units: "solely in accordance with commercial considerations", in the words of Article XVII of the GATT, that is, in response to factors such as price, quality, transportation

⁶⁷ Two works that come to mind readily are Edward Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, Mass.: Harvard University Press, 1929), and Joan Robinson, *The Economics of Imperfect Competition* (London: Macmillan, 1931).

⁶⁸ Articles 47 through 52, as well as Article 54, further defined the salient terms and specified the remedies available under the ITO. Article 53 made special provisions for handling restrictive practices in traded services. The full text is reprinted in Clair Wilcox, *A Charter for World Trade* (New York: Macmillan, 1949), pp. 281-287.

costs and similar terms of purchase or sale.⁶⁹ Thus, the external significance of divergent institutional features of domestic economies was assumed away. As noted above, the postwar economic regimes were assigned the tasks removing or lowering point-of-entry barriers such as quotas, tariffs, and currency exchange restrictions, as well as banishing deliberate acts of cheating such as export subsidies, dumping or currency manipulation.

Now that point-of-entry barriers have become progressively lowered or eliminated, the impact of domestic economic policies and institutional arrangements on international economic transactions has soared in salience. Over a decade ago, Richard Blackhurst, a well-known GATT staff economist, already foresaw "the twilight of domestic economic policies."⁷⁰ A shift was taking place, Blackhurst noted, in distinguishing between "international" and "domestic" economic policy: from a definition of international as border measures, to *any* policy, no matter what the instrument or where it was applied, which had an "important" impact on international transaction flows. Moreover, Blackhurst predicted,

barring either a major retreat into protectionism such as occurred in the 1930s or a massive reduction in the level of government intervention in the economy, the reclassification will continue into the foreseeable future, aiming towards an end point where few economic policies of any consequence will be considered primarily domestic.⁷¹

This trend to some extent affects monetary relations as well as trade. But it is more advanced in trade, and also more intense because domestic trade relief measures make compensatory and retaliatory moves more readily accessible. That, in turn, poses serious problems for the conduct of trade policy. The GATT is designed, in the words of one legal scholar, "to maintain a balance of [external] concessions and obligations, not to restructure nations."⁷² Yet "restructuring nations" – at least, aspects of nations – is what trade disputes increasingly have come to be about. Below, I describe briefly some of the subjects at issue, and indicate the array of possible implications for the governance of international trade relations.

⁶⁹ These words were taken almost verbatim from the ITO Charter, which the Soviets had a hand in drafting. See Jacob Viner, "Conflicts of Principle in Drafting a Trade Charter," *Foreign Affairs*, 25 (January 1947); and Herbert Feis, "The Conflict Over Trade Ideologies," *Foreign Affairs*, 25 (July 1947).

⁷⁰ Richard Blackhurst, "The Twilight of Domestic Economic Policies," *The World Economy*, 4 (December 1981).

⁷¹ *Ibid.*, p. 363.

⁷² Patricia Kalla, "The GATT Dispute Settlement Procedure in the 1980s: Where Do We Go from Here," *Dickinson Journal of International Law*, 5 (Fall 1986), p. 95.

Domestic Structures

One of the subjects at issue is domestic economic structures – defined broadly to include both government policies and policy networks, as well as patterns of private sector industrial organization. Sylvia Ostry, a former OECD official, differentiates three stylized forms among the leading capitalist countries: the pluralist market economy characteristic of the United States, the social market economy of Continental Europe, and Japan's corporatist market economy.⁷³ For the moment, Ostry would accept as "given" behavior, tastes, and institutions that have "cultural and historical roots," because the "appropriate domain of policy co-operation is government policy."⁷⁴ To reconcile the most serious trade effects of economic policy differences among these three forms of market economies, Ostry suggests, requires convergence in the following areas: competition policy, including merger law; research and development policies, especially subsidies; the asymmetry of access in the investment area, which largely targets Japan; and financial regulation as it affects corporate governance, such as, for example, bank ownership of firms. Even if we accept Ostry's concession to culture and history, achieving policy convergence in the areas on her list remains a daunting task.

The deepest difference on each of these policy dimensions lies between Japan and the other two, and the largest and most intractable trade imbalance is between Japan and the United States. As the Japan debate makes clear, a narrow focus on specific policies alone, as Ostry recommends, is simply not practical. At issue in that debate are the organization of Japan's labor market, capital markets, as well as ownership, production, and distribution systems; the economic role of the state; and, indeed, even the nature of its electoral system. All of these factors have been adduced as affecting Japan's trade and investment posture – and not simply by American "revisionists,"⁷⁵ but also by Japanese analysts and relatively dispassionate U.S. observers.⁷⁶ The experts

⁷³ Sylvia Ostry, "Beyond the Border: The New International Policy Arena," in OECD, *Strategic Industries in a Global Economy* (Paris: Organization for Economic Cooperation and Development, 1991), pp. 83-84.

⁷⁴ Ibid., p. 84.

⁷⁵ The exemplar of this school is Chalmers Johnson. Almost any work of his is relevant to this discussion, but see in particular "The Japanese Political Economy: A Crisis in Theory," *Ethics & International Affairs*, Vol. 2 (1988).

⁷⁶ See, for instance, Shigeto Tsuru, *Japan's Capitalism: Creative Defeat and Beyond* (Cambridge, England: Cambridge University Press, 1993). For a brief summary of various arguments about Japan's economic structure as it relates to international trade, see Daniel I. Okimoto, "Political Inclusivity: The Domestic Structure of Trade," in Inoguchi and Okimoto, *The Political Economy of Japan*. On industrial policy, see Daniel I. Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology* (Stanford: Stanford University Press, 1989); on investment policy, Dennis J. Encarnation, *Rivals Beyond Trade: America Versus Japan in Global Competition* (Ithaca:

disagree on whether these differences in economic structures are declining, as liberal economists tend to believe, or are more enduring features of Japanese society.⁷⁷ Alas, policy-makers elsewhere lack the luxury of waiting to find out who is right.

As difficult as it is, ultimately the highly charged case of Japan masks a more generic problem that would be with us in any event. Now that border barriers have been reduced to insignificant levels, domestic economic structures *ipso facto* are taking center stage in international trade disputes. If they diverge systematically and have "important" effects on international transaction flows, then an international political problem potentially exists.

The domestic economic structures of one's trading partners now enter the international trade policy agenda via "unfairness" claims. The potentially deleterious consequences are four-fold. First, what constitutes fairness in this regard tends to be determined unilaterally by the aggrieved party. As Hudec points out, "there are relatively few international agreements regulating the substance of such claims, and there is no recognized tribunal to adjudicate them in common law fashion."⁷⁸ GATT has nothing to say on the subject, and progress within the WTO is likely to remain modest, focused largely on such "traditional" issues as antidumping and countervailing duties.

Second, by their nature fairness claims call for unilateral concessions on the part of the accused party: "To say that certain conduct is unfair is to say that the guilty party must correct it for that reason alone."⁷⁹ Or, as Komiya and Itoh characterize U.S. demands regarding Japan's trade practices that it deems unfair: "Usually trade negotiations between two countries take the form of give-and-take, but in these negotiations, which have been going on almost continuously since 1976, the subject matter has been simply how much and how soon Japan would make concessions, with the United States offering little if

Cornell University Press, 1992); and on the nature of the electoral system as it affects multilateral commitments, see Peter F. Cowhey, "Elect Locally – Order Globally: Domestic Politics and Multilateral Cooperation," in John Gerard Ruggie, ed., *Multilateralism Matters* (New York: Columbia University Press, 1993).

77 The two positions are illustrated, respectively, by Bhagwati, *The World Trading System at Risk*, pp. 24-44; and Kozo Yamamura, "Will Japan's Economic Structure Change? Confessions of a Former Optimist," in Yamamura, ed., *Japan's Economic Structure* (Seattle: Society for Japanese Studies, University of Washington, 1990).

78 Robert E. Hudec, "Mirror, Mirror, on the Wall: The Concept of Fairness in United States Trade Policy," paper presented at the "Roundtable on Fair Trade, Harmonization, Level Playing Fields and the World Trading System: Economic, Political and International Legal Questions for the 1990s," Columbia University, 10 January 1992, p. 1.

79 *Ibid.*

anything in exchange."⁸⁰ In contrast, GATT processes, and presumably any future corresponding processes in the WTO, rest on mutual concessions as the basis for agreement unless specific legal obligations can be shown to have been violated. When it comes to fairness claims, therefore, the GATT and WTO are in the impossible position of having to cope with structural asymmetries by means of symmetrical accommodation.

Third, if policy harmonization were to become the preferred vehicle for dealing with the international effects of domestic policies and arrangements, questions such as these would arise immediately: harmonization to whose standard? Who decides whose standard will become the norm? And how? In addition, the slippery-slope of policy harmonization is steep: as indicated by the 240 items raised by the United States in the U.S.-Japan Structural Impediments Initiative talks, their potential scope is virtually without limit.

Fourth and finally, to the extent that unilateral measures become the instrument of choice to achieve, for instance, market access abroad – as it often has been for the United States in relation to Japan – when they are generalized across multiple issues and numerous countries the likelihood of retaliation and cycles of escalation can only grow.

In short, the premise that differences in domestic economic structures could be ignored in organizing the international trade regime no longer holds. Intrinsically, the issue has little to do with protectionism, though of course it is susceptible to capture by protectionist forces. It has everything to do with the growing irrelevance of the traditional distinction between "internal" and "external" policy domains – or with the contestation of where, precisely, the one ends and the other begins.

There are no obvious or simple solutions to the policy problems posed by this transformation. Blackhurst recommends that governments adopt new multilateral rules to defend themselves from pressures originating at home no less than abroad:

[G]eneral international rules are at least as useful in protecting a government from domestic interest groups as they are in protecting it from abuses by other governments. It is no paradox that the observance of general rules *increases* a government's freedom and ability to pursue genuine national interests.⁸¹

⁸⁰ Ryutaro Komiya and Motoshige Itoh, "Japan's International Trade and Trade Policy, 1955-1984," in Inoguchi and Okimoto, *The Political Economy of Japan*, p. 203.

⁸¹ Blackhurst, "The Twilight," p. 369, emphasis in original.

But the process will be more difficult than Blackhurst supposes. As Cowhey and Aronson have suggested, it will require a subtle but significant shift in the focus of commercial policy, away from trade per se toward the formal and informal conditions governing market access.⁸² Moreover, because non-border policies are in the hands of a variety of domestic agencies other than trade ministries, the collective policy process must include international agencies in addition to GATT/WTO.

For new multilateral rules to become feasible, however, it is first necessary to enhance the collective transparency of domestic economic structures and practices, devise commonly accepted definitions, collect comparable statistics, and conduct policy studies whose rigor and objectivity enjoy broad legitimacy among domestic economic policy officials in the major nations involved, and which would serve as the basis for systematic joint policy reviews. The relationship between competition policy, investment policy, and trade seem the most plausible initial candidates for such a regimen, though success cannot be taken for granted.⁸³ The OECD, with an expanded membership and mandate, is better equipped than any other international organization to undertake these complex and delicate tasks.⁸⁴

Greening Trade

With trade ministers and other high-level officials from 109 countries assembled to sign GATT's Uruguay Round accord in Marrakech, Morocco, in April 1994, U.S. Vice President Al Gore announced that Washington would seek to address the relationship between trade and the environment in future WTO negotiations – it had not gone far in the Round itself.⁸⁵ The Vice President is a committed and accomplished environmentalist in his own right. One suspects, however, that the close Congressional vote on NAFTA's ratifi-

⁸² Peter F. Cowhey and Jonathan D. Aronson, *Managing the World Economy: The Consequences of Corporate Alliances* (New York: Council on Foreign Relations, 1993), chap. 8.

⁸³ For a pessimistic scenario, based largely on institutional differences between Japan and the rest, see Karel van Wolferen, "Will The New World Trade Organization Work? No Chance – East and West Trade Won't Meet," *Washington Post*, June 26, 1994, p. C3.

⁸⁴ The Clinton administration made such a proposal in the spring of 1994. See Alan Riding, "O.E.C.D. Being Pressed to Change Its Mission," *New York Times*, June 5, 1994, p. D2. The OECD's predecessor, the OEEC, was established to monitor the implementation of the Marshall Plan. Whereas the Soviet Union rejected participation in the program for itself and its satellites, Russia has now signed an association agreement with the OECD, and Hungary, Poland, the Czech Republic, and Slovakia are "partners in transition." Mexico has become the first developing country to join.

⁸⁵ Alan Riding, "Gore Insists Environment is a Trade Issue," *New York Times*, April 15, 1994, p. D1; William Drozdiak, "Historic Trade Pact Signed, But Global Tensions Persist," *Washington Post*, April 16, 1994, p. A12.

cation also influenced the administration's position. Several major environmental organizations, notably the Sierra Club and Friends of the Earth, caught politicians by surprise when, together with organized labor, they orchestrated an effective campaign against the treaty, forcing the administration to negotiate a supplemental environmental accord.⁸⁶ (The same was true of labor standards, discussed below, the other future trade issue flagged by Gore at Marrakech.) Efforts to "green" trade had begun in earnest.⁸⁷

Gore's environment proposal received support from representatives of other industrialized countries, but developing countries were uniformly negative. The Indian Commerce Minister spoke for many: "We see no merit whatsoever in the attempt to force linkages where they do not exist."⁸⁸ Private commentators were less polite, accusing the industrialized world of practicing "ecoimperialism" in the name of spaceship earth while ignoring what Indira Gandhi as far back as the 1972 UN Conference on the Human Environment, held in Stockholm, had called "the pollution of poverty."⁸⁹ Along the way

⁸⁶ The ecology groups charged that NAFTA would not only export pollution to Mexico but also worsen transborder environmental problems along the 2,000-mile U.S.-Mexico frontier. See Tim Golden, "A History of Pollution in Mexico Casts Clouds Over Trade Accord," *New York Times*, August 13, 1993, p. A1.

⁸⁷ The event which fully mobilized the environmental movement against the trade regime was not pollution in Mexico but a 1991 GATT ruling against the United States having to do with the Mexican tuna-dolphin issue. A law suit brought by the Earth Island Institute, a California environmental group, forced a reluctant U.S. administration to impose a ban on the import of Mexican tuna caught using purse seine nets because that process also killed dolphins in excess of limits set by the U.S. Marine Mammal Protection Act. Mexico took the case to the GATT, which decided against the U.S. The ruling was so ultra-orthodox in its construction of the relevant GATT articles, however, that it lent itself to the interpretation that trade dominates the environment on principled grounds within GATT, and that unprotected common property resources have no standing in GATT trade law. Mexico became so concerned about the adverse impact of the ruling on prospects for NAFTA that it never sought to have it officially adopted by GATT. The case – and its significance for environmental politics – is discussed by Daniel C. Esty, *Greening the GATT: Trade, Environment, and the Future* (Washington, D.C.: The Institute for International Economics, 1994), pp. 29-33, and throughout.

⁸⁸ Cited in Riding, "Gore Insists," p. D2.

⁸⁹ Indeed, observers with longish historical memories recognized the inversion that Marrakech represented in the positions the industrialized "north" and developing "south" had held at Stockholm. There, developing countries sought in vain to introduce trade dimensions of environmental degradation to *their* advantage, but those efforts at "linkage politics," as it was termed, were abruptly rebuffed by the industrialized north, led by the United States. Developing countries asked, for example, that GATT and UNCTAD study the extent to which global pollution might be ameliorated by substituting natural products for synthetics; the U.S. opposed the proposal. Brazil argued that one reason for soil degradation and tropical deforestation in developing countries was the overutilization of marginal agricultural lands, due to low and unstable export prices – Brazilian coffee was cited as a case in point. Brazil proposed remedial action on prices and price stability for the raw materials exports of developing countries as a means of alleviating tropical rain

from Stockholm to Marrakech, the earlier affinity between environment and development groups has frayed, with major northern environmental organizations now forming alliances of convenience with, and providing new targets of opportunity to, the most protectionist segments of their domestic societies.

The trade-environment nexus is conceptually ill-defined, substantively highly complex and prone to perverse feedback effects, as well as exceedingly subjective.⁹⁰ Moreover, it pushes external transgression of the domestic policy domain well beyond the issue of economic structures and practices that may or may not affect trade, to include what economists like to call "tastes," or economically and culturally conditioned preferences and values – which environmentalists, in contrast, view as overriding concerns of universal validity. For present purposes, it is useful to distinguish three classes of cases.

The first concerns the trade effects of asymmetrical environmental standards. This has generated by far the most heat in policy circles. U.S. House of Representatives Majority Leader Richard Gephardt has promised to push for a "Green 301" provision, permitting the imposition of "ecoduties" on imports produced under conditions that are inferior to U.S. environmental standards; the Commission of the European Union has indicated that for the EU the issue of ecodumping is not negotiable; trade economists and GATT officials predict that the already fragile trade regime could unravel altogether under the strains of what might be called eco-countervailing wars; and policymakers in developing countries fear that staggering additional costs will further impede their development prospects.⁹¹

Among the major OECD countries, this issue can, and no doubt will, cause turmoil for some time to come. In the long run, however, there are reasons to believe that it should be largely self-correcting. For one, systematic differences in environmental standards among the leading trading nations are declining, and so too, therefore, are across-the-board (dis)advantages they may cause. This sets up a strategic situation in which "green retaliation" becomes more feasible than in the past, possibly serving as a deterrent and a stimulant to further policy convergence. Stronger efforts to implement the polluter-pays

forest depletion and soil erosion. The U.S. considered this a trade, not an environment, issue. And so it went. (Based on participant observation by the author, representing a nongovernmental organization.)

⁹⁰ Esty's book, *Greening the GATT*, is an admirable and environmentally-sensitive effort to establish some degree of conceptual order and policy priorities among the many and diverse issues involved. From a trade-dominant perspective, see "Don't green GATT," *The Economist*, December 26, 1992-January 8, 1993; and "The greening of protectionism," *The Economist*, February 27, 1993.

⁹¹ These and other positions are discussed in greater detail by Esty, *Greening the GATT*.

principle would help this process along.⁹² In addition, because environmental abatement expenditures tend to account for a relatively small share of the total cost of most final products, if countervailing ecoduties were to be imposed they would be relatively modest – and politicians might become persuaded that they are not worth the pains. Finally, if U.S. ecoduty unilateralism were to become a truly serious threat, it would be surprising if its major trading partners sooner or later did not challenge the substantial subsidy (or environmental cost) provided (imposed) by the very low U.S. energy prices relative to Europe and Japan.⁹³ Eco-countervailing those would overwhelm the value of any ecoduties the U.S. might levy in the first place. Accordingly, the most seriously affected targets of measures aimed at offsetting divergent environment standards are likely to be newly industrializing and developing countries. Not only are differences in their environmental conditions more pronounced, as is to be expected, but these countries typically lack the means to retaliate and deter.

A second class of cases concerns, not the environmental context within which goods are produced, but goods' environmental content. That content, in turn, can be defined as a product standard or a process standard. Product standards are hardly new, and exploiting their environmental variants for competitive advantage, while troublesome, poses no fundamental conceptual challenge for the trade regime.⁹⁴ What is new and difficult to accommodate is the notion that goods must be produced in accord with certain *processes* that are deemed environmentally sound. At the very core of nondiscrimination in international trade is the most-favored-nation norm, requiring that like imports be treated alike, as well as national treatment, requiring the no-less-favorable treatment of imports than of like domestic goods. "A car, for GATT, is a car. No, say the greens, it is also an assembly of metals and chemicals produced in certain ways"⁹⁵ – and they would treat cars and other imports differentially depending on certain environmental features of their production.

Among the OECD countries, the basic strategic situation that we described above for the issue of context standards may also, after much toing-and-fro-

⁹² Candice Stevens, "The Greening of Trade," *OECD Observer*, 187 (April/May 1994).

⁹³ Under the tightened subsidy rules devised in the Uruguay Round, the grounds presumably would be government revenues (energy taxes) foregone for the sake of achieving competitive advantage.

⁹⁴ U.S. Corporate Average Fuel Economy (CAFE) mileage standards for cars are illustrative. Though technically nondiscriminatory, in practice they discriminate against European upscale imports – in addition to excluding light trucks, which would lower U.S. fleet averages. A model-by-model tax would be truly nondiscriminatory. The case remains under review by a GATT panel. A brief description may be found in Esty, *Greening the GATT*, Appendix C.

⁹⁵ "The greening of protectionism," *The Economist*, February 27, 1993, p. 25.

ing, come to shape content standards. If not harmonization, then movement toward mutual recognition of standards may result where economic ties are particularly close.⁹⁶ Once again, therefore, newly industrializing and developing countries are likely to be most seriously affected. The Mexican tuna-dolphin case illustrates the problem. The trade-off was this: an economically efficient means of generating protein and export earnings on Mexico's side vs. the psychological spillover effects in the United States of knowing that a much-loved but non-endangered mammal was being excessively harmed in the process of tuna fishing on the high seas. Wanting NAFTA, Mexico lived with the U.S. ban even though GATT ruled it illegal.

Yet a third class of cases involves the use of trade restrictions against countries to achieve environmental objectives. Here too there are several variants. The least problematical is the situation in which an environmental treaty is in force which contains such sanctions as part of its implementation mechanisms. The Montreal Protocol on Substances That Deplete the Ozone Layer, for instance, bans trade in controlled substances even with nonparties.⁹⁷ A somewhat softer case is domestic legislation imposing trade sanctions on violators of an international environmental accord which does not itself, however, contain any such provision. U.S. trade restrictions on Norway for flouting the international whaling moratorium exemplify this variant. Both types of measures are generally viewed to make positive contributions at acceptable costs. Punitive trade measures in the pursuit of environmental goals become more problematical, however, when both the ends and means are unilaterally determined, and when they seek to impose the domestic preferences of one country on others. It may be true, as Jessica Mathews has argued in this regard, that "unilateral action... also goes by the name of leadership."⁹⁸ But that does not elevate every instance of unilateralism to an expression of leadership. Typically, the criteria for confirming leadership require, at minimum, acquiescence by others based on the perceived plausible legitimacy of an act, not on power asymmetries alone.

In coping with environmental cases of contested domestic domains – as well as protection of the global commons, a much larger subject than can be addressed here – the WTO will have to become environmentally more literate

⁹⁶ The European Union is a case in point. In NAFTA's environmental accord, Mexico undertook to strengthen enforcement of environmental laws already on the books, backed by a commission with the power to impose fines and trade sanctions. See Golden, "A History of Pollution."

⁹⁷ Richard Elliot Benedick, *Ozone Diplomacy* (Cambridge, Mass.: Harvard University Press, 1991). The protocol also includes the commitment to consider, within five years, extending trade restrictions to products made with controlled substances.

⁹⁸ Jessica Mathews, "The Great Greenless GATT," *Washington Post*, April 11, 1994, p. A19.

and better staffed than the GATT has been. Here too it will require assistance from the OECD, which has been active at the intersection of environment, competition, and trade policies for many years. Beyond that, successful efforts to strengthen international environmental agreements should reduce the heavy burden the trade regime now bears – though, as Esty acknowledges, some environmentalists oppose trade because they regard it intrinsically inimical to environmental quality.⁹⁹

Developing countries, as we have seen, are likely to remain more vulnerable. The reaction of their representatives to Vice President Gore's speech at Marrakech, therefore, is not surprising. Developing countries resist paying for global environmental degradation that was produced by the north at the same time as the north insists that the south neither magnify the problem nor negate efforts to arrest it, now that the north has begun to change its ways. Resolving this distributive dilemma would be exceedingly difficult under the best of circumstances. It is one thing to proclaim that environment and development need not stand in contradiction, and that, indeed, they converge in the concept of "sustainable development."¹⁰⁰ It is another to make it so. For example, there may be no single policy measure that would more greatly enhance the prospects for sustainable development in the north and south alike than lifting northern agricultural subsidies: they are hugely expensive, create environmental harm, and deprive developing countries of export markets where they have a clear comparative advantage, while forcing them into environmentally-degrading marginal production in the attempt to keep up commodity export earnings.¹⁰¹ Much the same is true of barriers imposed on some of their manufactured exports. As the *Economist* puts it: "Allow poor countries to sell shirts and shoes, and they are less likely to sell leather and logs."¹⁰²

In addition, punitive approaches to developing country environmental policies exact a high price: "Force the poor to apply first-world standards, and they will have less for health care and education."¹⁰³ Positive approaches on the part of the north include a greater commitment to technology transfer and additional financing of incremental environmental costs; and on the part of the south, moving toward incentive-based environmental strategies at home, and

⁹⁹ Esty, *Greening the GATT*, chap. 2.

¹⁰⁰ This concept was first officially advanced by the World Commission on Environment and Development (the "Brundtland Commission," named after its chair, Gro Harlem Brundtland, the Prime Minister of Norway), in *Our Common Future* (New York: Oxford University Press, 1987).

¹⁰¹ The United States and many other countries favored fairly rapid movement in this direction in the Uruguay Round, but ultimately had to compromise in the face of French opposition.

¹⁰² "Don't green GATT," p. 16.

¹⁰³ *Ibid.*

the adoption of so-called joint implementation mechanisms for international environmental accords, such as the global climate change convention.¹⁰⁴ Adding to the political weakness of the developing countries in the trade/environment area is the fact that they lack an OECD equivalent to help articulate and safeguard their collective interests, concerns, and policy options; neither UNCTAD nor the UN Sustainable Development Commission, established by the 1992 Rio Earth Summit,¹⁰⁵ is presently equipped to play that role.

Labor Standards

The other new trade-related issue that Vice President Gore sought at Marrakech to place on the WTO's future agenda was labor standards. In doing so, the *Washington Post* editorialized, "the Clinton administration is blowing a kiss to unions that are still sore about the free trade agreement with Mexico"¹⁰⁶ – a gesture undoubtedly also aimed at the broader electoral base of Ross Perot, still agitated by the predicted "giant sucking sound" of jobs moving south. The U.S. position was strongly backed by France. The developing countries finally acceded to having labor standards discussed, but not before accusing the north of generating "a new brand of protectionism," and warning against "the use of trade to bring external pressure for change in countries' domestic political or social structures."¹⁰⁷

In some respects, then, the issue of labor standards looks much like the issue of trade and environment. The major difference is that it will become almost entirely a north-south affair. The U.S. is unlikely to demand policy convergence with the European economies: work place conditions do not diverge significantly; and in a comparison with seven European nations, amenities favor European workers, U.S. manufacturing wages are lower than in all but

¹⁰⁴ By and large, developing countries have been extremely distrustful of incentive-based approaches for being too market-oriented. In the case of the climate change convention, developing countries have resisted, for the same reason, innovative proposals by some of the industrialized countries for abatement credits the industrialized countries would earn by reducing the often far worse pollution in third world countries. See Daniel Bodansky, "The United Nations Framework Convention on Climate Change: A Commentary," *Yale Journal of International Law*, 18 (Summer 1993). This developing country attitude may change now that their overall economic policy posture is changing.

¹⁰⁵ See *Earth Summit: Agenda 21* ["The final text of agreements negotiated by Governments at the United Nations Conference on Environment and Development (UNCED), 3-14 June 1992, Rio de Janeiro, Brazil"] (New York: United Nations, 1992).

¹⁰⁶ "Exporting Labor Standards," *Washington Post*, April 10, 1994, p. C6.

¹⁰⁷ The first comment came from Pakistan's Commerce minister, the second from Singapore's trade minister. See Riding, "Gore Insists," p. D2. See also Peter Behr, "New Trade Group Sets Talks on Labor Rights," *Washington Post*, April 8, 1994, p. D1.

Britain and France, while U.S. unions are the weakest.¹⁰⁸ Indeed, the contrast between the two policy arenas can be drawn more starkly. In the case of the environment, the United States seeks to project preferences abroad that reflect a strong domestic policy base; in the area of labor standards, the U.S. is as much pushed abroad by weakness in its domestic policy base that it has been unwilling or unable to fix. Pressure for protectionism from U.S. labor groups in the guise of the best interests of developing-country workers would be far less intense if this domestic weakness were dealt with more effectively. As a U.S. policy on labor standards and trade begins to emerge, therefore, one hopes that it will not neglect the domestic side.

It is well beyond the scope of the present study to suggest what a U.S. domestic labor market policy should look like.¹⁰⁹ But we can describe briefly what is lacking now, as it affects trade policy. U.S. trade adjustment assistance for labor was sharply reduced during the Reagan administration. But even before, the policy had done less and less to encourage "adjustment" – in the form of retraining workers displaced by imports for employment in more competitive industries, for example. In the end, it did little more than extend the duration of unemployment benefits.¹¹⁰ Indeed, the United States has done a poor job compared to its major OECD trading partners in devising an active labor market policy; it ranks last among them in government expenditures for that purpose – save for Japan which, with lifetime employment, has required no such policy.¹¹¹ Moreover, health care benefits for workers are more precarious and less portable in the U.S., while pension benefits are less secure. Outside the military, vocational training programs in the U.S. are fragmented, episodic and more often than not of low quality.¹¹² And long-term unemployment has remained high even when overall unemployment has declined. Perhaps the best that can be said for this policy posture is that the U.S. has the most flexible labor market of any OECD economy, which may be a desirable attribute in many respects. At the same time, however, future U.S. competi-

108 William Drozdiak, "New Global Markets Mean Grim Trade-Offs," *Washington Post*, August 8, 1994, pp. A1, A12.

109 An interesting set of proposals may be found in the most recent book by the current U.S. Secretary of Labor, Robert B. Reich, *The Work of Nations: Preparing Ourselves for 21st Century Capitalism* (New York: Knopf, 1991).

110 See Destler, *American Trade Politics*, pp. 152-153. The Clinton administration has proposed eliminating them altogether, and using the savings for more productive retraining efforts. See Frank Swoboda, "Reich Targets Several Job Programs," *Washington Post*, January 28, 1994, pp. A1, A10.

111 For a comprehensive survey of policies, see Thomas Janoski, *The Political Economy of Unemployment: Active Labor Market Policy in West Germany and The United States* (Berkeley and Los Angeles: University of California Press, 1990).

112 For example, Germany, with less than one-third the U.S. population, has nearly six times the number of industrial apprenticeships. "Training up America," *The Economist*, January 15, 1994, p. 27.

tiveness "is being threatened by a dearth of skilled workers"¹¹³ – and its trade policy by displaced skilled and unskilled workers who are the instrument of "flexibility" in the face of increased liberalization and lower-cost foreign competition.

When the U.S. policy focus shifts abroad to address labor rights and conditions in developing countries, advocates and policymakers alike appear to find it hard to resist the interstate commerce analogy. Accordingly, we can expect to be reminded frequently of Franklin Roosevelt's message to Congress in 1937 on the Fair Labor Standards Act: "Goods produced under conditions which do not meet a rudimentary standard of decency should be regarded as contraband and ought not to be allowed to pollute the channels of interstate commerce."¹¹⁴ But before this sentiment becomes U.S. trade policy scripture it will need to be tempered by the recognition that the United States could afford a substantially higher "standard of decency" in 1937 than prevailed at the time, and that a federal government existed which could legislate, enforce and, if necessary, help finance the cost of improvements.

Indeed, an appropriate international policy model on which to build already exists. Under the Generalized System of Preferences Act (GSP), developing countries are granted duty-free access to the U.S. market for many products, conditioned on their meeting five labor standards: freedom to associate, and to bargain collectively; the prohibition of forced or compulsory labor, as well as child labor; and a process for establishing a minimum wage, taking into account each nation's level of economic development.¹¹⁵ The GSP now includes phase-out and graduation provisions that would need to be reexamined, because they diminish the preferences granted to some of the newly industrializing countries whose labor standards are likely to be most at issue. In addition, the GSP forum for addressing possible violations would need to become a broader dispute settlement mechanism. Finally, the entire system would have to be brought under the WTO.

The ultimate sanction under the GSP scheme is denial of duty-free access to U.S. markets. The use of negative trade sanctions, which U.S. Labor Secretary Reich – no doubt for domestic consumption – has put high on what he calls "the menu" of possible actions, should be reserved as a last resort, and they should be deployed only for very specific and systematic violations of basic

¹¹³ Ibid.

¹¹⁴ Cited in Terry Collingsworth, J. William Goold, and Pharis J. Harvey, "Time for a Global New Deal," *Foreign Affairs*, 73 (January/February 1994), p. 10.

¹¹⁵ The GSP standards are briefly described in *ibid*.

rights, not for the global version of "great society" programs that Reich would have them seek to achieve.¹¹⁶

What conclusions can be drawn from this discussion of the growing intermingling of domestic and international economic policy domains? To begin with, it is important to remind ourselves that the postwar trade regime was designed to balance external obligations and concessions among nations, not to restructure their domestic economies. Indeed, the trade regime was premised on and promised a substantial degree of domestic policy autonomy as long as certain rules concerning external consequences were observed. With the virtual elimination of border barriers, however, restructuring aspects of domestic economies is what international trade policy increasingly has come to be about. For the major industrialized economies this process is occurring more indirectly in the monetary realm, working largely through constraints imposed by financial markets on domestic policy options, and only secondarily by means of policy coordination.¹¹⁷

The locus of multilateral economic policymaking is slowly changing as a result. At the "international" level it is moving away from single institutional focal points with exclusive sectoral responsibility, toward constantly shifting policy networks simultaneously involving several agencies and forums, each covering several areas of policy. In addition, multinational lobbying at the "domestic" level is becoming an increasingly important element in collective policymaking, with Washington serving as a central and highly accessible decisionmaking node in these policy networks, and Brussels, of course, playing an analogous role in the European Union. Beyond that, governments are employing unilateral, bilateral, as well as plurilateral strategies, including regionalism, in the attempt to fill in policy voids.

What remains far from clear, however, is the substantive principles on which future multilateral policy frameworks may come to be based. The

¹¹⁶ Robert B. Reich, "Escape From the Global Sweatshop," *Washington Post*, May 22, 1994, pp. C1, C4. Reich's article gave every appearance of being a policy trial balloon, and it used as its rhetorical foil a "leader" (editorial) in *The Economist*, categorically rejecting trade sanctions as a means to enhance labor standards in developing countries. See "Free trade or foul?" *The Economist*, April 9, 1994. As it often does, *The Economist* got the final word: "More than any other sort of economic policy, trade policy is prone to capture by narrow interests. The pressure to protect producers from foreign competition is intense and relentless. A new set of excuses for protectionism against imports from the third world (under Mr Reich's criteria, the list, written out in full, would be the most contentious and extensive ever devised) is certain to mean higher trade barriers and less trade, not just for the worst offenders on labour standards, but for others too." *The Economist*, "Economic Focus," June 4, 1994, p. 70.

¹¹⁷ For the developing countries, the international monetary regime has been much more intrusive all along, by virtue of IMF conditionality in return for access to its resources.

problem is particularly pronounced between, using Ostry's terms, the U.S. "pluralist" and European "social market" economies, on the one hand, and Japan's "corporatist" form, on the other. The road to reconciling the external divergencies of these domestic economic forms will continue to be bumpy because visibility is poor, the available maps inadequate, and the metrics of measuring distance or proximity only marginally better than guesswork.

Globalization

Much has been written about globalization and nearly as much has been dismissed as "globaloney." Milton Friedman, as is his wont, has put the negative case most categorically: "The world is less internationalized in any immediate, relevant, pertinent sense today than it was in 1913 or in 1929."¹¹⁸ Friedman contends that the divergence between the price of the same good in different countries that became distinctly pronounced after the Great Depression has remained in place despite steadily decreasing transportation costs, thus "demonstrating vividly how powerful and effective government intervention has been in rendering the law of one price far less applicable after 1931 than it was before."¹¹⁹

Friedman's observation that the world economy is far from being a single economy governed by the law of one price, such as the U.S. economy started to become toward the end of the last century, is largely correct – but also irrelevant to the point at issue. Globalization today is assuming various microeconomic forms of increasingly extensive, diverse, and integrated institutional webs forged within markets and among firms across the globe. Illustrating the poverty of conventional concepts, this phenomenon typically is described as "off-shore" markets and "off-shore" production, as if they existed in some ethereal space waiting to be reconceived by the economic equivalent of relativity theory.

¹¹⁸ Milton Friedman, "Internationalization of the U.S. Economy," *Fraser Forum*, February 1989, p. 10.

¹¹⁹ Ibid. In a controversial paper published a quarter century ago, Waltz advanced a similar argument, using as his measures of internationalization (1) the size of the external sector of the major economic powers relative to their domestic economies, and (2) the degree of intersectoral specialization in their trade. Kenneth N. Waltz, "The Myth of National Interdependence," in Charles P. Kindleberger, ed., *The International Corporation* (Cambridge, Mass.: MIT Press, 1970). With intrasectoral trade flows dominating among the major economies, the second part of Waltz's definition is a truism. The first is less the case today than it was in 1970, but more importantly it is also less relevant, for reasons we shall discuss presently.

Most international economists have devoted little attention to these organizational forms because institutional economics is not much in vogue among them. The conventional notions of international politics do not go far to describe or explain them either, whether the liberal proclivity to discover that sovereignty is everywhere at bay or the realist security blanket under which nothing ever fundamentally changes. Little can be established conclusively about this transformation yet because no official definitions exist of the relevant categories of analysis and so no uniform data are collected. The simplest of typologies will help us grasp intuitively the issues at stake, however. They derive from the work of the otherwise unlikely pairing of business school economists and their economist counterparts on the left, together with organizational political scientists and sociologists. The first is the distinction between markets, hierarchies, and networks.¹²⁰ The second is the distinction between goods and services. A stylized discussion of these forms and their policy implications follows.

Markets

One of the core premises of the postwar economic regimes was that international economic transactions are conducted at arms-length between distinct and disjoint national economies. Several private-sector institutional transformations have called this premise into question, as also the policy measures based on it. The first concerns the mediating mechanism of the market itself.

International markets not only have expanded steadily, they have also acquired historically unprecedented forms. The most significant institutional changes exhibited by international financial markets are their growth, diversification, and integration across national economies – beyond even the wildest expectations of policymakers when they first decided to unleash them. Once an adjunct of trade, financial transactions now tower over annual trade flows by a ratio of at least 50:1. In addition to old-fashioned investment capital, there are international markets in currencies and equities, as well as derivatives of all of these, including options, futures, swaps and other means of hedging. Although

¹²⁰ The standard conceptual works are Oliver E. Williamson, *Markets and Hierarchies* (New York: Free Press, 1975), and Walter W. Powell, "Neither Market Nor Hierarchy: Network Forms of Organization," *Research in Organization Behavior*, Vol 12 (Greenwich, CT: JAI Press, 1990). For a suggestive application of these concepts to the evolution of international corporate strategies and structures, see Stephen J. Kobrin, "Beyond Geography: Inter-Firm Networks and the Structural Integration of the Global Economy," (Philadelphia: William H. Wurster Center for International Management Studies, Wharton School, University of Pennsylvania, WP 93-10, November 1993).

they are physically separated, these markets are global in that they "function as if they were all in the same place"¹²¹ – in real time and around the clock.

This evolution – perhaps revolution is the more appropriate term – has serious consequences for economic policymaking. Virtually by definition, previously assumed cause-effect relations and trade-offs, between exchange rates and trade balances, say, or between interest rates and exchange rates, are bound to be confounded by the complexities of this new financial world. Cooper summarizes the general point thusly: "When markets evolve to the point of becoming international in scope the effectiveness of traditional instruments of economic policy is often greatly reduced or even nullified."¹²²

The international markets for goods and services, similarly, have expanded and diversified. But their most significant institutional change is the fact that they have become overshadowed altogether by new organizational forms which internalize both production and exchange within global corporate structures. We briefly describe two characteristic forms and their implications for policy.

Hierarchies

The rate of increase in international production – that is, production by multinational enterprises outside their home countries – began to exceed the rate of increase in world trade by the 1960s. Sometime in the 1980s, the actual volume of international production began to exceed trade flows. Today, the worldwide sales of multinational firms, at \$5.5 trillion, is only slightly less than the entire U.S. Gross Domestic Product (GDP). U.S.-based multinationals play a major role in international production; their revenues from manufacturing abroad are now twice their export earnings.¹²³

Accordingly, a recent U.S. Department of Commerce study sought to measure how different the U.S. position in world markets would look if the standard balance-of-trade measure were combined with the net effects of sales by U.S.-owned companies abroad and of foreign-owned companies in the United

¹²¹ John M. Stopford and Susan Strange, *Rival States, Rival Firms: Competition for World Market Shares* (Cambridge, England: Cambridge University Press, 1991), p. 40.

¹²² Richard N. Cooper, *Economic Policy in an Interdependent World* (Cambridge, Mass.: MIT Press, 1986), p. 96. A senior executive of Gillette, a major multinational consumer products firm, gives concrete expression to this generalization: "In the long run... currency fluctuations, up and down, don't mean a whit in the decision where to manufacture." Cited in Louis Uchitelle, "U.S. Corporations Expanding Abroad at a Quicker Pace," *New York Times*, July 25, 1994, p. D2.

¹²³ "The discreet charm of the multicultural multinational," *The Economist*, July 30, 1994, p. 57.

States. It found that on this more inclusive indicator of global sales and purchases of goods and services the U.S. consistently has been earning a surplus, rising from \$8 billion in 1981 to \$24 billion in 1991, even as its trade deficit deteriorated during the same period from \$16 billion to \$28 billion.¹²⁴ Nevertheless, the conduct of U.S. trade policy and the invocation of trade relief measures continue to be driven by trade imbalances, which every year reflect less well the actual U.S. position in world markets. (The new measure would not significantly alter the U.S.-Japan imbalance, however, because of asymmetries in investment access to the U.S. and Japan, together with the more pronounced tendency by Japanese multinationals to import from home-country suppliers rather than purchasing locally.¹²⁵)

Thus, the fact that U.S. firms now produce more abroad than they export is in itself important. But an even more profound institutional shift follows from it: the dominant mode of organizing goods production and exchange in the world economy increasingly is "through administrative hierarchies rather than external markets."¹²⁶

The process began simply enough. For a variety of reasons, firms set up subsidiaries abroad to service local markets. Over the course of thirty years or so, the process became transformed into "the global factory."¹²⁷ Led initially by the automobile and consumer electronics industries, components production, sourcing, assembly, and marketing by multinationals spread across an array of countries, exploiting the shifting advantages of different locales. Today, this pattern includes even the most advanced technological sectors. "The popular IBM PS2 Model 30-286 contains: a microprocessor from Malaysia; oscillators from either France or Singapore; disk controller logic array, diskette controller, ROM and videos graphics from Japan; VLSI circuits and video digital-to-analog converter from Korea – and it's all put together in Florida."¹²⁸

124 J. Steven Landefeld, Obie G. Whichard, and Jeffrey H. Lowe, "Alternative Frameworks for U.S. International Transactions," *Survey of Current Business*, December 1993.

125 It is, of course, the case that some substantial – though contested – share of this imbalance is due to U.S. domestic macroeconomic imbalances. Encarnation, in *Rivals Beyond Trade*, stresses the impact of investment asymmetries as well as differential patterns of sourcing and intrafirm trade flows. Also see Mordechai E. Kreinin, "How Closed is Japan's Market?" *The World Economy*, 11 (December 1988); and United Nations Centre on Transnational Corporations (UNCTC), *World Investment Report, 1991: The Triad in Foreign Direct Investment* (New York: United Nations, 1991).

126 Stephen J. Kobrin, "An Empirical Analysis of the Determinants of Global Integration," *Strategic Management Journal*, 12 (Summer 1991), p. 20.

127 Joseph Grunwald and Kenneth Flamm, *The Global Factory: Foreign Assembly in International Trade* (Washington, D.C.: The Brookings Institution, 1985).

128 Walter B. Wriston, "Bashing Japan With Flawed Figures," *Washington Post*, August 4, 1994, p. A31. Also see Cowhey and Aronson, *Managing the World Economy*, chaps. 5-

As a result of this transformation, the template – the mental picture of the economic world – on the basis of which postwar economic policymaking and the international economic regimes were conceived has been rendered obsolete. In that picture, production was national, and countries were linked into an international division of labor by arms-length trade, portfolio investment, and direct investment in raw materials sectors or to secure local market access. Today, in significant measure the international division of labor is becoming *internalized* at the level of firms. Integrated administrative structures that span the globe increasingly manage the design, production, and exchange of parts, components, and finished products; the allocation of strategic resources, including funds and skills; and the synoptic plans that rationalize these processes, including their location, for success in a competitive environment that is itself increasingly global. In short, for virtually every major industry, manufactures or services, the primary mode for the international organization of economic transactions has shifted away from reliance on international markets to include global administrative hierarchies.¹²⁹ Thus, even as borders have become everywhere more open, in this specifically institutional sense global production and exchange may be said to have become more "closed." And even though states are actively involved in bargaining with individual firms about conditions of access, for example, nowhere is economic policymaking remotely equipped to deal with the systemic policy consequences of this shift.¹³⁰

For example, one consequence is the growth of intrafirm trade – trade among subsidiaries or otherwise related parties. As of now, few official and uniform intrafirm trade statistics are collected. Episodic studies show that it is growing at a rate considerably more rapid than conventional trade. And they indicate that it is far less sensitive than conventional trade to such policy instruments as exchange rates.¹³¹ Other policy-related concerns that have been

7, which include case studies of automobiles, semiconductors, and telecommunications services.

¹²⁹ Kobrin's papers have been particularly helpful to me in conceptualizing this transformation; see "An Empirical Analysis of the Determinants of Global Integration," and "Beyond Geography." For a critical account of its consequences, in the industrialized countries as well as the third world, see Richard J. Barnett and John Cavanagh, *Global Dreams: Imperial Corporations and the New World Order* (New York: Simon & Schuster, 1994).

¹³⁰ See David M. Gordon, "The Global Economy: New Edifice or Crumbling Foundations?" *New Left Review*, 168 (March/April 1988), who also adds a useful corrective by pointing out that "global" refers to the span of firms *not* to the universal spread of capital, which limits itself to "a few carefully chosen locations" (p. 57).

¹³¹ See Jane Sneddon Little, "Intra-Firm Trade: An Update," *New England Economic Review* (May/June 1987); Mark Cassons, *Multinationals and World Trade* (London: Allen & Unwin, 1986); and the earlier but still useful study by Gerald C. Helleiner, *Intra-Firm Trade and the Developing Countries* (London: Macmillan, 1981).

raised about it include transfer pricing for the objectives of cross-subsidization and minimizing tax obligations.

Furthermore, this institutional transformation on occasion has begun to turn the conduct of U.S. trade policy into an almost metaphysical exercise – poignantly captured by Robert Reich's question: *Who is US?*¹³² For example, the U.S. International Trade Commission (ITC) found itself confronted not long ago with antidumping charges brought by a Japanese firm producing typewriters in the U.S. against an American firm importing typewriters into the U.S. from off-shore facilities in Singapore and Indonesia.¹³³ The confusion is not limited to trade policy. During the Bush administration, the Pentagon became concerned about the fact that large and long procurement runs were unlikely to persist widely in the future and sustain the U.S. defense-industrial base. Among other options, the Pentagon considered a "reconstitution" model. However, it proved extraordinarily difficult to decide whether to define the entity that should be available for reconstitution by nationality of ownership, production locales, contributions to the economy, or citizenship of researchers – the divergence between these indicators of national identity being so pronounced – or to determine whether such units, however defined, would be available for "reconstitution" when needed.¹³⁴ The growing tendency by U.S. firms to internationalize research and development in costly high technology sectors has raised related concerns.¹³⁵

Finally, this institutional transformation challenges what was perhaps the central relationship in the entire postwar American political economy. As Cowhey and Aronson depict its model of industrial organization, the federal government assumed that its primary role was to manage levels of consumer spending, provide R&D funding, and otherwise help socialize the costs of technological innovation via military procurement and civilian science pro-

¹³² Reich, *The Work of Nations*, chap. 25.

¹³³ The case involved Brothers Industries Ltd., a Japanese concern assembling typewriters in Bartlett, Tennessee, and Smith Corona, a U.S. concern doing the same off-shore. Adding another element of complexity, Smith Corona is owned 48 percent by Hanson P.L.C., a British group. See Robert B. Reich, "Dumpsters," *The New Republic*, 10 June 1991, p. 9; and David E. Sanger, "A Twist in Fair Trade Case: Japanese Charge a U.S. Rival," *New York Times*, August 12, 1991, p. D1. Sanger's story also points out that Chrysler almost inadvertently filed an ITC claim against *itself* when it charged Japanese firms with dumping minivans in the U.S. market – one of the vehicles covered by the definition was made for Chrysler by Mitsubishi. The Brothers request subsequently was denied, the ITC concluding that the firm was not enough of a domestic producer to claim injury.

¹³⁴ Based on personal interviews.

¹³⁵ Andrew Pollack, "Technology Without Borders Raises Big Questions for U.S.," *New York Times*, January 1, 1992, p.1.

grams. The major U.S. companies would take it from there.¹³⁶ Today, not only is it getting harder to determine whether something is an American product any longer, as Reich observes, but more importantly whether the legal designation, "an American corporation," describes the same economic entity, with the same consequences for domestic employment and economic growth, that it did in the 1950s and 1960s.¹³⁷ The NAFTA debate about how many U.S. jobs would be lost or gained made it clear how little is known about the links between transnationalized production and trade policy, on the one hand, and domestic employment and economic growth, on the other. But it also demonstrated that previous premises about the nature of economic entities and relationships no longer fully capture essential features of the U.S. political economy.

This form of, in essence, denationalization may be welcomed by trade theorists and academic specialists in trade law, on the belief that it will enhance global economic efficiency and welfare while decreasing government intervention and thereby reduce trade disputes. But it may have just the opposite effect. If governments find that their array of policy tools, including the relatively benign option of the "new protectionism," no longer suffice to achieve their objectives, there is no telling what measures they might turn to in exasperation. The appropriate posture of "cosmopolitan" policy analysts, therefore, is not to applaud the failure of "parochial" governments, but to help them devise new means to do their jobs.

Networks

Even as analysts and policymakers are still trying to assimilate the consequences of globally integrated structures of production and exchange, the corporate world has already pushed ahead with the next generation of institutional innovations. Generically, these have been described as network forms of organization; in large-scale, high-technology sectors they are more commonly known as "strategic alliances."¹³⁸

Networks... are especially useful for the exchange of commodities whose value is not easily measured. Such qualitative matters as know-how, techno-

¹³⁶ Cowhey and Aronson, *Managing the World Economy*, pp. 16-17.

¹³⁷ Reich points out that of the \$20,000 an American consumer paid in 1991 for a Pontiac Le Mans, about \$6,000 went to South Korea for parts and operations, \$3,500 to Japan, \$1,500 to Germany, and an additional \$1,400 to various suppliers of products and services in these and other countries; less than \$8,000 of the total paid for goods and services that were produced in the United States. *The Work of Nations*, p. 113.

¹³⁸ See Powell, "Neither Market Nor Hierarchy," and Kobrin, "Beyond Geography." The most extensive discussion to date of the policy implications of strategic alliances is Cowhey and Aronson, *Managing the World Economy*.

logical capability, a particular approach or style of production, a spirit of innovation or experimentation, or a philosophy of zero defects are very hard to place a price tag on. They are not easily traded in markets nor communicated through a corporate hierarchy.¹³⁹

In addition, the sheer size of investments and magnitudes of risks in many rapidly changing areas of high technology increasingly are beyond the capacity of even the largest firms, driving them to establish alliances.¹⁴⁰

Paraphrasing Powell's typology, networks are a collaborative form of organization, based on complementary strengths, characterized by relational modes of interaction, exhibiting interdependent preferences, stressing mutual benefits, and bonded by reputational considerations. The field of strategic alliances is dominated by technology-intensive industries, such as semi-conductors, telecommunications, commercial aircraft, and automobiles. The major home bases of firms entering into alliances are the U.S., European Union (especially Germany), Japan, and Korea. Finally, Powell suggests that, as the globally integrated firm is discovering strategic alliances at the high end of R&D and in some instances production, it is also rediscovering the market at the low end of standardized components.¹⁴¹

Numerous questions attend the future of strategic alliances, especially how viable and permanent a form they really are. As the *Economist* warns: "Managing such vaguely defined relationships is difficult enough at the best of times; distance, language and culture bring added complications. Add to this the fact that many networks are in the business of closing plants and refashioning markets, and you have a recipe for trouble."¹⁴² But if networks were to become a central and permanent feature of international economic organization, then the focus of collective economic policy-making inevitably would have to shift toward some type of global industrial policy. At minimum, this would entail negotiating market access, as Cowhey and Aronson suggest. But negotiating market shares might not be far behind.¹⁴³

Intangibles

The distinction between goods and services is the one final conceptual clarification we shall introduce to elucidate the institutional transformation of the

139 Powell, "Neither Market Nor Hierarchy," p. 304.

140 Kobrin, "Beyond Geography," stresses this particular causal factor.

141 Powell, "Neither Market Nor Hierarchy."

142 "The discreet charm of the multicultural multinational," p. 58; see also "Does it matter where you are?" *The Economist*, July 30, 1994.

143 Cowhey and Aronson, *Managing the World Economy*, chaps. 8-10.

world economy in recent decades. Services used to be the "invisibles" appendage to merchandise trade: shipping, insurance and the like, as well as tourism. Today the list is longer, the magnitude much higher, and services are said to be "traded" in their own right. In addition to the old items, the list now includes information services, various financial, professional and business-related services, construction, cultural services, and many more. Their volume has reached somewhere between one fifth and one quarter of total world trade, though because of definitional and statistical anomalies the balance of world services imports and exports routinely is off by \$100 billion or so per annum – and that still understates hard-to-measure services that are embodied in traded products, such as design, engineering, or data processing. The expansion of traded services is accounted for, in the first instance, by transnationalized goods production, but also by technological developments, especially the informatics revolution, and domestic deregulation, particularly of capital markets and telecommunications.

The institutional challenge posed by traded services is not quantitative, however, but qualitative. The GATT was designed for merchandise trade: ball-bearings and bananas cross frontiers, passing through customs houses on the way. Invisibles were left uncovered by GATT. Indeed, according to an etymological survey by Drake and Nicolaidis, services had not been regarded as being "traded" before 1972, when they were first so construed in an OECD experts' report: "the group took a huge leap by suggesting tentatively that the transactions in services could be considered trade, that the principles and norms for trade in goods might apply, and that the challenge in the emerging transition was to avoid "protectionism"."¹⁴⁴ As the world's largest producer and "exporter" of services, the United States quickly embraced these notions. The U.S. pushed for GATT rules to govern traded services as early as the Tokyo Round of the 1970s, but with little success. The U.S. also had great difficulty getting services onto the agenda of the Uruguay Round, and when it did succeed the victory initially appeared largely symbolic.¹⁴⁵ But in the end the Round did produce a General Agreement on Trade in Services (GATS).

¹⁴⁴ William J. Drake and Kalypso Nicolaidis, "Ideas, Interests, and Institutionalization: "Trade in Services" and the Uruguay Round," *International Organization*, 46 (Winter 1992), p. 45.

¹⁴⁵ For a brief summary, see "Nothing to lose but its chains: A Survey of World Trade," *The Economist*, September 22, 1990. The United States was rebuffed at a 1982 GATT ministerial meeting, even by its OECD partners, in attempting to have the GATT secretariat merely catalogue impediments to international service transactions. The best it could do was to obtain approval for the idea that interested countries could conduct their own national studies of services and report back to GATT. At a 1984 meeting of GATT contracting parties the United States sought to have a GATT working party on services established. By then the U.S. was supported by most OECD countries but opposition from developing countries was adamant; they were led by India and Brazil (which subsequently became targets of "Super 301" investigations), and supported by an

The GATS essentially consists of a set of general principles, a number of special conditions or exceptions, and initial liberalization commitments.¹⁴⁶ Traded services generally are to be governed by the classical GATT principles of nondiscrimination and transparency of domestic rules and regulations, but countries have the right to exclude specific services from the principles of national treatment and the right of market access. Safeguards provisions are included and mechanisms for dispute settlement provided for. In short, trade in services will be brought under the GATT/WTO umbrella with an ultimate balance of obligations between domestic and international objectives which is more qualified than for merchandise trade, and also more individualized.

It is important to realize, however, that the GATS only marks the conclusion of one chapter in a continuing story of very difficult economic diplomacy. It brings within the conventional trade framework that portion of traded services which countries are willing to fit into it. A number of highly contentious issues remain beyond the reach of this framework. Intrinsically, that fact has little to do with what one normally regards as trade barriers or protectionism, but stems largely from the unique attributes of services that differentiate them from goods.

First, because the concept of services has no well-established place in economic theory, its definition tends to be ad hoc and arbitrary: intangible activities not included in agriculture, mining and manufacturing.¹⁴⁷ Attempts to define services more theoretically have focused on their being non-storable, therefore requiring simultaneity in provision and use. But this insight has generated endless lists that can be endlessly argued about, rather than a finite and universally agreed set. With tongue only half in cheek, the *Economist* once

UNCTAD study which claimed that a services agreement would disadvantage the developing countries. (See UNCTAD, *Services and the Development Process* [Geneva: United Nations Conference on Trade and Development, 1984]. Among other things, the document denied the role of comparative advantage in services and stressed the salience of infant industry arguments.) In a compromise with developing countries, a more informal group was established. When the Uruguay Round was launched in 1986, most developing countries still opposed having services on the agenda, but by then the newly industrializing countries had become interested and thus a face-saving way to include services was found.

¹⁴⁶ See Drake and Nikolaidis, "Ideas, Interests, and Institutionalization;" and John M. Curtis and Robert Wolfe, "Nothing is Agreed until Everything is Agreed."

¹⁴⁷ Good discussions of the general conceptual issues attending the definition of services may be found in Jagdish Bhagwati, "Trade in Services and the Multilateral Trade Negotiations," *The World Bank Economic Review*, 1 (No. 4, 1987), and by the same author, "International Trade in Services and its Relevance for Economic Development," in Orio Giarini, ed., *The Emerging Service Economy* (London: Pergamon Press, 1987). On related problems in banking services, see "A Question of Definition: A Survey of International Banking," *The Economist*, April 7, 1990; and for informatics, "Netting the Future: A Survey of Telecommunications," *The Economist*, March 10, 1990.

proposed defining services as "Things which can be bought and sold but which you cannot drop on your foot."¹⁴⁸ But in fact architectural plans, computer disks and magnetic tapes, not to mention Big Macs in Moscow or Budapest can be dropped on one's foot. In short, unlike the case of merchandise trade, in traded services the very definition of the phenomenon remains subject to strategic behavior by governments – the major cleavage being between capital and technology intensive services provided by the industrialized countries, and the labor intensive services of developing countries. There is no reason to expect that contested definitions will disappear because a GATS has been reached.

Second, governments typically regulate domestic service industries more rigorously than other economic activities. Entry into many services, such as medicine, law, or accounting is strictly licensed; governments often still reserve the right to approve utilities prices, which in many places still include transportation and telecommunications; financial institutions, such as banks, insurance firms, and securities traders are subject to prudential supervision; and in many countries the state still owns outright certain service industries. Most of these regulatory objectives and instruments were not designed with trade in mind. The principles of nondiscrimination, transparency, and national treatment where it applies should moderate somewhat the impact of differences in national regulatory environments, but they will not eliminate the problem.

Furthermore, despite what Drake and Nicolaidis characterize as the "revolution in social ontology" that reconceived services, the fact remains that relatively few services are "traded" in any recognizable sense of the term. In merchandise trade, the factors of production and the consumers stand still while the finished product moves. In traded services, the factors of production do the moving while the product is fixed in location. Thus, trade in services amounts to provider-mobility across borders. No economic theory justifies, however, why provider mobility should encompass U.S. banks and insurance firms offering financial services in Seoul, for example, but not South Korean construction workers providing their services in Seattle – an issue that exercised developing countries during the GATS negotiations, and which will remain contentious in the future. Indeed, because of how difficult it is to accommodate such trade-offs in the domestic politics of the OECD countries, it would not be entirely surprising if a second "ontological revolution" were to occur somewhere down the road, this time tying services more closely to the realm of investment policy rather than trade.

¹⁴⁸ "A Gatt for Services," *The Economist*, October 12, 1985.

Finally, one suspects that service-related conflicts will be higher in the Asia-Pacific area, particularly vis-à-vis Japan, than elsewhere among the industrialized countries. Regulatory environments are more opaque there, inviting the imputation of worst-case motivations. And if past experience from the difficulties encountered in the areas of direct foreign investment and patent protection is any guide, then in Japan, at any rate, the efficacy of institutional solutions like the right of establishment may prove elusive and generate as many bilateral disputes as they resolve.¹⁴⁹

Thus, the expansion of traded services reinforces the trend toward intermingling domestic and international issues and processes, as well as contesting domestic domains, as central elements of international economic policymaking. The GATS represents an important first step, but little more, in providing some degree of order to how the consequences are managed.

Welfare Capitalism

In the autumn of 1993, the editors of the *Economist* thought they detected and they vigorously applauded – a new grand economic strategy on the part of the Clinton administration, offering Americans what the journal described as a new deal. "Its outlines are simple: you accept change (such as the North American Free Trade Agreement) and we'll help to give you security" – occupational, health care, and personal security.¹⁵⁰ The *Financial Times* later that year, even while editorially basking in "the most capitalist Christmas in history," reflected on the pressing need for a new deal for the entire capitalist world:

The world is changing rapidly; the Atlantic nations in general and Europe in particular face competition from the younger, harsher, more robust capitalism of south Asia. ... Even the middle classes, who have benefited most from economic growth, fear that they may lose what they have, while those out-

¹⁴⁹ The most egregious patent case, of course, concerns the integrated circuit. Texas Instruments, its inventor, applied for a patent in Japan on February 6, 1960; it was granted effective October 30, 1989, by which time Japanese firms accounted for nearly all sales in Japan and large chunks of the world market. Thomas C. Hayes, "Japan Grip Still Seen On Patents," *New York Times*, November 24, 1989; and David E. Sanger, "Contrasts on Chips," *New York Times*, January 18, 1990. More recently, U.S. firms, including Texas Instruments, have brought successful suits against Japanese firms for past infringements of intellectual property rights. "When copying gets costly," *The Economist*, May 9, 1992. Moreover, both the World Intellectual Property Organization and the WTO plan to take a more active role in harmonizing patent systems among the U.S., Europe, and Japan.

¹⁵⁰ "In search of security," *The Economist*, October 16, 1993, p. 25.

side note that however rich the super-rich may get, large-scale unemployment persists. Lower down the income scale the picture is far worse. ... If welfare capitalism is to be sustained, its managers must find new means of controlling its cost, and minimising the cost to employers. Radical policies, centred around the notion of giving the poor a hand-up rather than a hand-out must be pursued.¹⁵¹

These two British newspapers are among the most irrepressible and articulate advocates anywhere of free markets and free trade. What, then, possessed them to worry about the economic security of workers and sustaining welfare capitalism – and, even more curiously, to suggest that governments have a role to play in achieving those objectives? The answer is really quite simple. Both realize that the extraordinary success of postwar international liberalization has hinged on a domestic social compact between the state and society. Both see that this social compact is everywhere fraying. And both fear that if it unravels altogether, so too will liberalization.

Social expenditures began to rise rapidly in the OECD countries in the 1960s, and now average roughly one-third of GDP. But contrary to widespread misconceptions in the United States, these expenditures leveled off some time ago. In the U.S. they nearly doubled from roughly ten percent of GDP in 1960 to just under nineteen in 1975. But they peaked there, and by 1985 had drifted lower than a decade before. Indeed, in 1985 only Spain and Japan devoted a smaller share of GDP to social expenditures than the United States.¹⁵² On the other hand, the U.S. economy has generated far more jobs than any other in the OECD for the past two decades, though the uniformity of their quality is in dispute and long-term unemployment has increased.¹⁵³

In Western Europe, the social safety net has held up more firmly than in the U.S., but at the cost of eroding competitiveness and an anemic rate of job creation. Production costs are among the highest in the world, thanks to generous benefits and high payroll taxes, and the work force is immobile and inflexible. As a result, unemployment is at a postwar high, averaging eleven percent. The situation is far worse in Eastern Europe. It remains masked in Japan by the

¹⁵¹ "Capitalism at Christmas," *Financial Times*, December 24, 1993, p. 6.

¹⁵² OECD, *The Future of Social Protection* (Paris: Organization for Economic Cooperation and Development, 1988), Table 1, p. 10.

¹⁵³ As the senior economist of the National Association of Manufacturers – which is not usually closely allied with labor – recently stated: "There are large numbers of temporary, part-time and contract workers out there who are counted as employed but are in reality competing for permanent jobs... There are enormous amounts of disguised slack in the labor market." Cited in Louis Uchitelle, "A Matter of Timing – Debate on the Fed's Latest Rate Increase Focuses on Capacity and Wage Demands," *New York Times*, August 18, 1994, p. D16.

employment practices of firms, but is a latent threat.¹⁵⁴ Surveying these trends, Paul McCracken, who chaired President Nixon's Council of Economic Advisers, recently reached a somber conclusion in the *Wall Street Journal*: "Those entering the work forces in Western Europe and even in the U.S. confront labor market conditions more nearly resembling those of the late 1930s than those prevailing during the four decades or so following World War II."¹⁵⁵

Budget deficits and tax-averse publics make it impossible for governments to expand the web of social policies that have characterized welfare capitalism since World War II. Even for the most social democratic and neocorporatist welfare states, the costs have become unsustainable. Moreover, there is a growing sense that some of these policies have become part of the problem, not the solution, due not only to their financial burden but also because many are perceived not to work well any longer and even to create perverse disincentives. U.S. Labor Secretary Robert Reich reflected a growing consensus in proposing recently that several job-related social programs be terminated. "Investing scarce resources in programs that don't deliver cheats workers who require results and taxpayers who finance failure."¹⁵⁶

Efforts to radically overhaul the capitalist welfare state cannot focus only on retrenchment, however, if the project of international liberalization is to remain domestically viable. To succeed, these efforts must "review and redesign," not merely "slash and trash," in the words of Lloyd Axworthy, Canada's Liberal Minister of Human Resources.¹⁵⁷ Kenneth Clarke, Britain's Tory Chancellor of the Exchequer, echoes the sentiment: "I intend," he said at the outset of a recent speech, "to extol the virtues of both a flexible labour market and a strong welfare state. ... I believe that, properly directed, the two complement one another."¹⁵⁸ And President Clinton warned the allies at the NATO summit in January 1994 that unless the United States, Europe, and Japan create greater economic and social opportunities at home, "it will be

- 154 See Ferdinand Protzman, "Rewriting the Contract for Germany's Vaunted Workers," *New York Times*, February 13, 1994; "Europe and the Underclass," *The Economist*, July 30, 1994; Steve Coll, "Economic Change, Social Upheaval," *Washington Post*, August 7, 1994, pp. A1, A24; and Drozdak, "New Global Markets Mean Grim Trade-Offs."
- 155 Paul McCracken, "Costlier Labor, Fewer Jobs, Unemployment – The Crisis Continues," *Wall Street Journal*, January 7, 1994, p. A10.
- 156 Cited in Swoboda, "Reich Targets Several Job Programs," p. A1.
- 157 Cited in Geoffrey York, "Grits vow radical social reform," *Globe and Mail* (Toronto), February 1, 1994, p. A7.
- 158 Cited in "Mr. Clarke's manifesto," editorial, *Financial Times*, May 5, 1994, p. 17.

difficult for the people of... all our nations to continue to support [a] policy of involvement with the rest of the world."¹⁵⁹

And so, the compromise of embedded liberalism has come around full circle. Governments once again are groping to find a mutually compatible set of policies for international and domestic stabilization. But they are doing so in an institutional context wherein little remains the same but an implicit normative commitment to sustain both, and in an international political environment in which their common enemy is not a clear and present geopolitical threat but more diffuse fears of the consequences of policy failure.

Conclusion

When all is said and done, I concur with the assessment of David Gordon, the well-known radical economist, that "we have been witnessing the decay of the postwar global economy rather than the construction of a fundamentally new and enduring system of production and exchange."¹⁶⁰ My reasoning, however, is not driven by any inherent contradictions in the laws of capitalist development. It draws instead on the core insight of Carr and Polanyi that no system of production and exchange can long endure in the modern world unless it is embedded in a framework of political legitimacy that can derive only from its responsiveness to shared social purposes.

The new world economy that has emerged over the past few decades poses far greater challenges to governments than the traditional stabilization issues discussed in the previous section precisely because it is disembedded in several key dimensions. The first is in its policy templates: the mental maps of spaces and structures with which policymakers visualize the basic contours of their world. These have been severely strained and even left behind by the breakdown in the distinction between domestic and international policy realms; the shift from markets to hierarchies and alliances as core forms in the global organization of production and exchange; and the growing role of the ontologically ambiguous transactions called traded services. The second and related source of disembeddedness is the world of policymaking itself. International as well as domestic economic policy targets are increasingly elusive because instrumentalities are no longer as effective. This ineffectiveness, in turn, reflects the fact that the theoretical, conceptual, and statistical infrastructure of policy too often still reflects previous policy templates and the cause-effect relations that pertained in that earlier world. Lastly, the new world economy is increas-

¹⁵⁹ Cited in E. J. Dionne, Jr., "Europe's Preoccupation," *Washington Post*, January 11, 1994, p. A11.

¹⁶⁰ Gordon, "The Global Economy," p. 54.

ingly disembedded from the domestic social compact between state and society on which the political viability of the postwar international economic order hinged. Policy attitudes toward the new world economy have shifted in the direction of neoliberalism to an extent that is beginning to be of concern even to staunch guardians of market orthodoxies in the leading financial journals of Britain and the United States. Slowly, policymakers are rediscovering the organic link between domestic social and economic security on the one hand, and the durability of international systems of production and exchange, on the other.

Constructing the 1995 analogue to the 1945 embedded liberalism compromise, needless to say, is a herculean task. Last time around, the most decisive negotiations took place between two countries, the United States and Great Britain, with Canada at times mediating between the two of them – and on other occasions between the U.S. State Department and Treasury. This time, because of the diffusion of economic power but also due to the nature of the issues themselves, the relevant parties must include all leading capitalist nations, in many cases the newly industrializing countries, and in some instances members of the poorer developing world. What is more, last time around there was widespread consensus about what needed to be done and how to do it in the professional circles on whose work policymakers drew – in the relevant "epistemic communities," as I have called them elsewhere.¹⁶¹ Today, it seems more appropriate to speak of epistemic disarray in the community of scholars and policy analysts. Finally, the overall international geostrategic situation is very different today. That does not make agreement impossible, but it requires more precise quids-pro-quos to be devised. In sum, it is exceedingly unlikely that any new grand bargain can be forged except in the most general of terms. At best, therefore, we are likely to see a series of overall normative framework agreements coupled with their specific operationalization in specific sectors, based on varying levels of commitments, made by shifting groups of countries. Making sure that these more minilateral and plurilateral schemes remain compatible with the animating principles of multilateralism remains perhaps the toughest challenge of all.

¹⁶¹ John Gerard Ruggie, "International Responses to Technology: Concepts and Trends," *International Organization*, 29 (Summer 1975), esp. pp. 569-570. For an elaborate application to the postwar economic negotiations, see G. John Ikenberry, "A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement," *International Organization*, 46 (Winter 1992).

Biographical Note

John Gerard Ruggie is Dean of the School of International and Public Affairs at Columbia University, New York City. This monograph draws on the author's forthcoming book, *America and the New World Order: Multilateralism After the Cold War*, commissioned by the Twentieth Century Fund.

